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No. 195

In the Supreme Court of the United States

OCTOBER TERM, 1943

NORTHWESTERN ELECTRIC COMPANY AND AMERICAN POWER & LIGHT COMPANY, PETITIONERS

v.

FEDERAL POWER COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION

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OPINIONS BELOW

The first opinion and order of the Federal Power Commission (1 R. 36–78) are reported in 36 P. U. R. (N. S.) 202. The second opinion and order of the Commission (5 R. 1164–1173) are reported in 43 P. U. R. (N. S.) 148. The opinion of the circuit court of appeals on review of the first order (4 R. 806–819) is reported in 125 F. (2d) 882. The opinion of the court on review of the second order (6 R. 1230–1241) is reported in 134 F. (2d) 740.

JURISDICTION

The judgment of the circuit court of appeals on review of the first order was entered February 13, 1942 (4 R. 819), rehearing was denied on March 13, 1942 (4 R. 825), and petitioner did not seek certiorari. Its judgment on review of the second order was entered on March 27, 1943 (6 R. 1242). Rehearing was denied on May 22, 1943 (6 R. 1243). The petition for a writ of certiorari was filed on July 23, 1943, and was granted on October 11, 1943. Jurisdiction of this Court rests upon Section 313 (b) of the Federal Power Act (49 Stat. 860, 16 U. S. C. 825 *l*), and Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Following extensive hearings, the Federal Power Commission, by an opinion and order, determined, pursuant to the Federal Power Act, that the electric plant accounts of Northwestern Electric Company contained a "write-up" and directed Northwestern to amortize such "write-up" by charging earned surplus each year with an amount equal to the excess of its net income over its preferred stock dividend requirements. The Commission granted a rehearing with respect to the method of disposing of the "write-up," but denied a rehearing as to the remainder of the order. The court below affirmed the portion of the order as to which rehearing was denied

and no certiorari was sought. Following the rehearing and oral argument before the Commission *en banc*, it directed that the "write-up" be disposed of in the manner prescribed in its first order. On review, the Commission's second order was affirmed by the court below. The questions are:

1. Whether the Federal Power Commission may prescribe a uniform system of accounts which is based upon cost and requires that "write-ups" be segregated in an adjustment account, pending such disposition as the Commission may approve or direct.

2. Whether the Commission was authorized to require Northwestern to dispose of the "write-up" by charging earned surplus each year with an amount equal to the excess of its net income over its preferred stock dividend requirements.

3. Whether the prescribed disposition violates the Fifth or Tenth Amendment to the Constitution.

STATUTE INVOLVED

The relevant provisions of the Federal Power Act are set forth in Appendix A, *infra*, pp. 74–86.

STATEMENT

The Petitioners

Petitioner, Northwestern Electric Company ("Northwestern"), is a wholly-owned subsidiary of petitioner, American Power & Light Company;

which in turn is a subholding company in the Electric Bond & Share Company system. Northwestern is engaged in the production and sale of electric energy in the states of Oregon and Washington, its principal distribution areas being Portland, Oregon, and Vancouver, Washington. Northwestern owns and operates facilities for the transmission and sale of electric energy at wholesale in interstate commerce and admittedly is a "public utility" within the meaning of the Federal Power Act of 1935 (3 R. Ex. 3, pp. 3–4; Pet. Br., p. 5).

Preliminary Proceedings Before the Commission

On May 27, 1939, Northwestern filed with the Federal Power Commission a proposed reclassification of its electric plant accounts pursuant to the requirements of the Commission's Uniform System of Accounts for Public Utilities and Licensees (3 R. Ex. 1; Ex. 6, p. 38), and filed an identical reclassification of its accounts with the Public Utilities Commissioner of Oregon (1 R. 458).[1] A joint investigation of such reclassification was undertaken by the staffs of the Federal Power Commission and the Oregon Commissioner, the results being embodied in a joint report (3 R.

[1] The Oregon Commissioner, as well as the Department of Public Service of Washington, has prescribed substantially the same system of accounts as the Federal Power Commission (1 R. 478; 3 R. Ex. 29).

Ex 3).[2] In that report, the staffs found that all of Northwestern's common stock, having a present par value of $3,500,000, had been issued to the company's promoters without consideration, and recommended that the balancing entry of $3,500,000 in Northwestern's electric plant accounts should be removed therefrom and transferred to Account 107, Electric Plant Adjustments, pending submission of a plan for its disposition (1 R. 141; 3 R. Ex. 3, pp. 17, 25, 29). The report was served upon Northwestern by the Commission with the request that it adjust its accounts in conformity therewith and "submit a plan for disposing of" the "write-up" (1 R. 141). Upon Northwestern's failure to comply with these requests (1 R. 143–151), a hearing was held before the Commission on July 22–August 1, 1940. Extended testimony and numerous exhibits (1 R. 152 to 3 R.) were introduced.

The "Write-Up"

Northwestern Electric Company was organized in 1911, under the laws of Washington, by two San Francisco promoters, Herbert and Mortimer Fleishacker, who desired to acquire a water-power site to develop electricity for a paper mill in

[2] The Washington Department was unable to join in the examination due to other engagements of its staff, as set forth in its *amicus* brief urging support of the Commission's order in the court below. A copy of that brief, as well as the *amicus* brief filed below by the Oregon Commissioner, is being filed with the Clerk of this Court.

which they were interested (1 R. 13–16, 440; 2 R. 513). The promoters advanced $175,000 to the company for acquisition of the sites, which amount, with interest, was repaid by the company (2 R. 726–727). In 1911, the promoters of Northwestern caused the company to issue to them 50,000 shares of common stock having a par value of $5,000,000, under a resolution stating that it was in payment for "riparian lands, water rights and other properties," although the company admittedly did not receive any land, water rights, or other property from the promoters (2 R. 522, 526, 759; 5 R. 1063). On May 14, 1912, the company's common stock was increased by an additional 50,000 shares, to a total par value of $10,000,000, under a resolution of the board of directors which recited that the amount of the company's capital "actually paid in is Five Million Dollars" (2 R. 753–754). The second 50,000 shares were issued to the promoters on the same day, May 14, 1912, without any formal subscription (2 R. 522, 712). On April 8, 1914, the company's authorized capital stock was further increased by 20,000 shares of 6% cumulative preferred stock having a par value of $2,000,000 (2 R. 756). This was done under a resolution which recited that the amount of the company's capital stock "actually paid in is $10,000,000.00 Dollars" (2 R. 757). The $10,000,000 of common stock issued to Northwestern's promoters in 1911 and 1912 was first recorded on its books by journal entry of January 31,

1914, which credited that amount to the liability account, "Common Capital Stock," and balanced it by a charge to the asset account, "Land and Water Rights" (1 R. 467–468; 2 R. 534–535).[3] Thereafter, on April 12, 1915, the issuance of the second 50,000 shares of common stock to the promoters was "ratified, approved, and confirmed" by a resolution which stated that "there was a valuable consideration" for the issuance of such stock, consisting of the "valuable services" which had been rendered by the promoters after they received the first 50,000 shares and before they received the second (2 R. 627–628).

In the meantime, on July 1, 1913, Northwestern became subject to the system of accounts prescribed by the Public Utilities Commissioner of Oregon (2 R. 534), which contained the standard provision that all charges to the fixed capital or other property accounts "should be the actual money cost of the property" and where the consideration given for property was other than money, the charge should be the "actual money value of such consideration at the time of the transaction" (2 R. 631, 562). Beginning in 1914, Northwestern reported the $10,000,000 common stock item to the Oregon Commissioner as part of the company's landed capital (2 R. 535–537), although admittedly this was not in accord with the facts (1 R. 259; 2 R. 535).

[3] The plant account of Northwestern, including the $10,000,000 item, then totalled $13,984,621 (2 R. 534–535, 644).

In 1925, petitioner, American Power & Light Company ("American") purchased the entire $10,000,000 of Northwestern's common stock for some $5,021,799.33 in cash (5 R. 927), approximately 60% of the stock being acquired from the promoters and the balance from the public (5 R. 1063–1064).[4] At the time American acquired the stock, the price thereof on the San Francisco Stock and Bond Exchange ranged from 32½ to 47⅞ (5 R. 968).

In 1932, Northwestern was involved in a rate proceeding before the Oregon Commissioner. It there admitted that it "could find nothing to support $9,600,000" of the $10,000,000 in the asset accounts (2 R. 670, 697) but contended that as of July 1, 1914, the promoters' services to Northwestern had a cash value of $400,000 (1 R. 260–261; 2 R. 665, 697). The Oregon Commissioner in that proceeding found that "no consideration was received for the common stock", (2 R. 781–782). Northwestern then removed the $10,000,000 from its asset account "Land and Water Rights." However, despite the finding of the Oregon Commissioner that the $10,000,000 represented no consideration received, the company transferred $400,000 of that amount to an asset account entitled "Organization" although it had never pre-

[4] The promoters had turned over some 45,000 shares of the common stock as a bonus to the subscribers for the preferred stock to make the latter "more attractive and salable" (1 R. 16).

viously been considered by the company as an organization expense (2 R. 537–538), and transferred the balance of $9,600,000 to an asset account entitled "Miscellaneous Non-Operating Intangible Capital" (2 R. 538).

In 1934, a small number of Northwestern's preferred stockholders owning approximately 84 shares (5 R. 970, 992–995) brought suit against Northwestern and American to cancel the common stock or compel American to pay Northwestern therefor (5 R. 1066–1067).[5] On August 18, 1936, that suit was compromised before trial, pursuant to a stipulation which provided for the reduction of the par value of the common stock from $10,000,000 to $3,500,000 (5 R. 1044–1047).[6] The reduction of the par value of Northwestern's common stock was approved by the Washington

[5] In 1935, Northwestern obtained relief under Section 77–B of the Bankruptcy Act. The Oregon Commissioner and the Washington Public Service Department appeared in the proceeding and advised the federal court that the book value assigned to the common stock "was excessively over-stated, and that the presence of such excessive figures of value had been and continued to be a serious detriment to the debtor and created a situation adverse to the public interest" (2 R. 583–584). By order of the court, the maturity date on Northwestern's bonds was extended ten years. Moody's *Public Utilities* (1935), p. 1502; *id.* (1936), p. 1972.

[6] American's agreement to the reduction was based upon the understanding that Northwestern regarded its balance sheet liability of $10,000,000 on account of the common stock as an obstacle to the payment of dividends upon its preferred stock (5 R. 878). The dividends on the cumulative preferred stock were then $1,267,406.55 in arrears (5 R. 889).

Public Service Department with the express understanding that it constituted a "voluntary reduction by applicant of the stated value of its common stock," and should never be construed as constituting a determination by the Department of the value of the common stock or the value or cost of Northwestern's assets (2 R. 585–586). In substantially similar language, the Oregon Commissioner also gave his approval to the "write-down" (2 R. 580).

The "write-down" was reflected on Northwestern's books as of September 16, 1936, by reducing the asset account "Miscellaneous Non-Operating Intangible Capital" from $9,600,000 to $3,100,000 and the liability account "Common Capital Stock" from $10,000,000 to $3,500,000. The asset account "Organization" remained at $400,000. (1 R. 466, 468–469.) As of December 31, 1936, Northwestern again adjusted the entries on its books, this time by transferring $300,000 on the asset side from "Organization" to "Miscellaneous Non-Operating Intangible Capital" (1 R. 469–470; 2 R. 768). Finally, in its proposed reclassification of accounts submitted in May 1939 pursuant to the requirements of the Federal Power Commission's Uniform System of Accounts, Northwestern combined the foregoing amounts and reported $3,500,000 in the asset account "Organization" (1 R. 470).

THE COMMISSION'S ORDERS AND THE DECISIONS BELOW

On December 6, 1940, after the close of the hearing before the Commission (*supra*, p. 5), and the filing of detailed briefs, the Commission issued an opinion and order containing findings of fact (1 R. 36–78). The Commission found that Northwestern had received no assets of any kind, either in cash, services, or property, tangible or intangible, in return for its common stock, which the company's promoters had issued to themselves, and that the balancing entry in Northwestern's electric plant accounts was therefore a "write-up" (1 R. 62). The Commission accordingly ordered Northwestern to transfer the "write-up" of $3,500,000 to Account 107, Electric Plant Adjustments (1 R. 72), where it would become subject to disposition "as the Commission may approve or direct" (3 R. Ex. 6, p. 19).[7] The Commission, although recognizing that it would be justified under proper accounting principles to order an immediate write-off of the item, nevertheless, after consideration of all relevant factors including "the interest of consumers, investors and the public" (1 R. 69), ordered Northwestern to amortize the "write-up" by charging its earned surplus account each year,

[7] The text of Account 107 (3 R. Ex. 6, p. 19) provides in part that "Write-ups of electric plant prior to the effective date of this system of accounts shall be recorded herein" and "shall be disposed of as the Commission may approve or direct."

beginning in 1940, with an amount equal to the excess of its net income over its preferred-stock dividend requirements.* Northwestern's application for rehearing (1 R. 79–111) was granted on January 21, 1941, for the purpose "only of permitting the presentation of a plan of disposition of the amount of $3,500,000 write-up" (1 R. 113). Northwestern thereupon petitioned the court below for review of the Commission's order, and the court reviewed and affirmed the provisions thereof as to which rehearing had been denied by the Commission, not passing upon the provisions as to which rehearing had been granted (4 R. 806–819). Northwestern did not seek certiorari, and, as required by the Commission's order and the judgment of the court entered February 13, 1942, it classified the "write-up" in Account 107, Electric Plant Adjustments (4 R. 820, 822; 5 R. 1190, 1195).

In the meantime, at the rehearing and subsequently in oral argument before the Commission

* Paragraph 2 (a) of the Commission's order provided that (1 R. 78): "(2) Northwestern Electric Company make the following disposition of the amounts recorded in Account 107, Electric Plant Adjustments: (a) For each year, commencing with the calendar year 1940, it shall credit Account 107, Electric Plant Adjustments and charge Account 414, Miscellaneous Debits to Surplus with a sum equal to its Net Income (Account 400, Credit Balance Transferred from Income Account) less its Preferred Stock Dividend requirements [1 R. 69; 6 R. 1241] for each such calendar year until the amount of $3,500,000 shall have been entirely extinguished."

en banc, Northwestern and American[9] failed and refused to submit any plan for the elimination of the "write-up," their counsel stating that their "only plan of disposition, if you want to call it that, was one of indisposition to do anything about it" (5 R. 1080). The Commission, by a second opinion and order, thereupon again directed that the "write-up" be amortized by annual charges to earned surplus, as it had prescribed in its first order (5 R. 1164–1173). The Commission found that although it could have ordered "the $3,500,000 item to be charged at once to the earned surplus of the company," elimination of the "write-up" by a "series of charges, to earned surplus over a period of years in the future" would avoid creating a present deficit in earned surplus and would therefore be "reasonable and in the public interest" (5 R. 1168, 1169).[10]

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[9] American, which presently owns Northwestern's common stock, was granted leave to intervene in the rehearing. 2 F. P. C. 859. It did not seek to intervene in the first hearing.

[10] The Commission's second order of April 14, 1942, provided that (5 R. 1173): "(A) Northwestern Electric Company make the following disposition of the amounts recorded in Account 107, Electric Plant Adjustments, as directed in this Commission's order of December 6, 1940: For each year, commencing with the calendar year 1940, it shall credit Account 107, Electric Plant Adjustments, and charge Account 414, Miscellaneous Debits to Surplus, with a sum equal to its Net Income (Account 400, Credit Balance Transferred from Income Account) less its Preferred Stock Dividend requirements [1 R. 69; 6 R. 1241] for each such calendar year until the amount of $3,500,000 shall have been entirely extinguished."

On review, the court below affirmed the Commission's second order on March 27, 1943 (6 R. 1242). A petition for rehearing was denied on May 22, 1943 (6 R. 1243).

SUMMARY OF ARGUMENT

On the first appeal, the court below had before it for decision the propriety of the Commission's Uniform System of Accounts; the Commission's requirement that Northwestern conform its books of account to the system and make certain specific entries therein; the Commission's ruling that the $3,500,000 item was a "write-up" to be placed in Account 107 where it became subject to disposition by the Commission; and finally the company's contention that the accounts prescribed by the Commission improperly made no allowance for plant appreciation or present value. It upheld the authority and rulings of the Commission in respect of these matters. Under well-settled principles, all matters which the court below decided or could have decided are *res judicata*. We suggest that the issue in the instant case may be limited solely to the method of disposition prescribed by the Commission.

I. Section 301(a) of the Federal Power Act confers comprehensive accounting authority upon the Commission. The exhaustive report presented to Congress by the Federal Trade Commission which, in part, formed the basis of the Federal Power Act of 1935, disclosed abuses in the

public utility field which could best be corrected through the exercise of comprehensive accounting authority by a federal agency. The legislative history of the Act discloses that it was intended to confer such accounting authority upon the Federal Power Commission. The language of Section 301(a) itself is sweeping in its grant of accounting authority to the Commission and the only limitation thereon is that the rules and regulations prescribed must be necessary or appropriate for the performance of the duties entrusted to the Commission by the Act. The comprehensive character of the grant of accounting authority conferred by Section 301(a) has been upheld by the federal courts.

2. The Commission was authorized to prescribe a uniform system of accounts based on cost, excluding any fluctuations of plant values and requiring the elimination of items which do not reflect cost. The determination of what is appropriate for the carrying out of its duties is a matter for the Commission and will not be judicially reviewed as long as any rational basis therefor may be found. The system must be uniform, both to afford a ready basis for comparison and to apply even-handedly to all "public utilities." It may appropriately be based upon cost because many of the duties imposed upon the Commission by the Act require cost data, and it may exclude therefrom fluctuations in the value of electric plant, both because such exclusion is in accord-

ance with approved accounting principles and because any attempt to record current values in the accounts would defeat the basic purposes of the system. For purposes of comparison and for ready reference, the Commission has a right to prescribe the accounts in which certain classes of entries shall be made and the accounts in which specific items shall be debited or credited. Accordingly, when an item is encountered in the public utilities' asset accounts which does not represent cost, the Commission properly may require that item, after investigation and hearing, to be classified according to its true nature and placed in an adjustment account pending disposition. The $3,500,000 item in the instant case was properly classified as a "write-up" and was properly placed in Account 107, Electric Plant Adjustments. The text of this account provided that "write-ups" placed therein should be disposed of as the Commission may direct.

3. The method of disposition of the $3,500,000 "write-up" directed by the Commission was appropriate in the circumstances of this case. The item was unquestionably a "write-up." There was no asset account on the balance sheet in which it could be entered and, although afforded opportunities so to do, petitioners declined to suggest any method of disposition but demanded that the item be retained permanently in Account 107. The Commission's order therefore properly di-

rected that it be amortized by an annual charge to earned surplus in an amount equal to the excess of its net income over preferred stock dividend requirements. The Commission might have required an immediate charge of the entire item to earned surplus under approved accounting methods. In exercising its discretion by entering a less drastic order, it cannot be said to be arbitrary nor to have unduly invaded the field of management, especially where "management" had declined to act. Nor did such requirement constitute a reorganization or quasi reorganization. The order of disposition does not conflict with any provision of the Public Utility Holding Company Act of 1935 or any order of the Securities and Exchange Commission thereunder. That commission has repeatedly recognized the propriety of the control exercised by the Federal Power Commission over the accounts of operating public utilities. Inasmuch as the order of the Power Commission did not purport to control the payment or nonpayment of dividends, there was no conflict with the authority of the S. E. C. in that respect.

4. The order of the Commission did not constitute a taking of petitioners' property. No property whatsoever has been taken from either Northwestern or American, and all basic rights which the latter had as a stockholder in Northwestern, it still retains. Nor is there any attempt to usurp state functions by assessing American for the un-

paid purchase price of the stock, nor any invasion of the powers reserved to the states under the Tenth Amendment. A proper exercise of a right under the commerce clause of the Constitution must always prevail over state authority. The approval by the Oregon and Washington state authorities of the voluntary reduction of Northwestern's capital stock from $10,000,000 to $3,500,000 explicitly disavowed any intention to approve the amount of the reduction as sufficient.

ARGUMENT

At the outset, we believe it necessary to suggest again to the Court, as we did in our brief in opposition, that there is not properly before this Court for decision the issue of whether the Commission correctly ordered Northwestern to transfer $3,500,000 from its electric plant accounts to Account 107, as a "write-up" to await further order of disposition of the Commission; nor the issue of whether the Commission may direct disposition of that item. The issue properly before this Court on review of the Commission's second order appears to be limited to the authority of the Commission to direct disposition of the "write-up" in the manner prescribed—by annual charges against the earned surplus account.

The Commission's first order of December 6, 1940, ordered the transfer to Account 107 of the $3,500,000 item found to be a "write-up" (1 R. 62), and also ordered that it be amortized by an-

nual charges against earned surplus (by an amount equal to the excess of net income over preferred stock dividend requirements) (1 R. 78). Northwestern's application for rehearing was denied as to the first part of the order, and granted as to the second part for the sole purpose of affording Northwestern an additional opportunity to present an alternative method of disposing of the "write-up" (1 R. 112–113). Thereupon, while rehearing was pending on the second part of the order of December 6, 1940, Northwestern petitioned the court below for review of that order, thus submitting to the court below all parts of that order except that relating to the method of disposing of the "write-up." The court consequently had before it the Commission's finding that the $3,500,000 item was a "write-up"; the Commission's order directing Northwestern to reclassify its electric plant accounts in accordance with the uniform system prescribed by the Commission; and the Commission's order prescribing the entries to be made in each account, including the transfer of $3,500,000 to Account 107. The opinion of the court below on the first review specifically upheld the uniform system of accounts prescribed by the Commission, and the classification of the $3,500,000 item as a "write-up." Its decree required that the "write-up" be classified in Account 107, Electric Plant Adjustments (4 R. 820, 822). The uniform system of accounts before the court was clearly set up on a cost basis and

did not permit the reflection of fluctuations in the value of electric plant; consequently, in approving it the court below necessarily determined that the Commission could prescribe a system of accounts which is based on cost. And in requiring that the "write-up" be classified in Account 107, after its character as a "write-up" had been determined following notice and hearing, the court below necessarily held that this item was no longer an asset and marked it for disposition. *A. T. & T. Co.* v. *United States,* 299 U. S. 232, 239, 240, 242.[11] The text of Account 107 itself makes plain that amounts recorded therein cannot remain there permanently, but must be disposed of as the Commission may

[11] Particular attention is directed to the form of the judgment entered by the court below on the first review (4 R. 819–825). The court followed the rather unusual procedure of setting out verbatim in its judgment the first order of the Commission. The court then ordered and adjudged that the Commission's order, as so set out, "be, and it hereby is affirmed, except paragraph (2a) of said Order, with respect to which the Commission granted a rehearing by order entered January 21, 1941, and except that part of paragraph (3) of said Order of December 6, 1940, which provided for the filing by respondent of certified copies of the journal entries required by said paragraph (2a); and the said Northwestern Electric Company is hereby directed to comply with the order of the said Federal Power Commission of December 6, 1940 with the exceptions as stated above, and notify the said Federal Power Commission in writing on or before May 29, 1942 what steps the said Northwestern Electric Company has taken to comply herewith." Paragraph (2a), which was thus excepted from the order of affirmance, related solely to the method of disposition of the amounts recorded in Account 107, Electric Plant Adjustments (4 R. 824, 825).

approve or direct (3 R. Ex. 6, p. 19); hence the court below necessarily decided on the first review, that the Commission had power to direct disposition of the "write-up" from Account 107. There being no account on the asset side of the balance sheet into which this item could be moved, the power of disposition must relate to transfer into the surplus account on the liability side.

This analysis of the scope of the decision on the first review is confirmed by the opinion of the court below, on its review of the Commission's second order (issued on April 14, 1942), which had again directed amortization of the "write-up" by annual charges to earned surplus (5 R. 1164–1173). On the second review, the court once more rejected the company's "fair value" argument, which this time was asserted as a bar to the disposition ordered by the Commission. The court thus clearly disclosed that on the first review it had decided the question of the authority to order disposition.[12]

[12] Petitioners contend that this constitutes a requirement of automatic disposition of amounts classified in Account 107, Electric Plant Adjustments, contrary to this Court's holding in *A. T. & T. Co.* v. *United States*, 299 U. S. 232 (Pet. Br. 77). Apart from the factual distinction between that case and the one at bar (see pp. 36–37, *infra*), there has been strict adherence in the instant case to the rule announced in the *A. T. & T.* case—viz., that the items in the adjustment account could properly be disposed of after the character of the item had been determined. This Court there ruled that such disposition "must depend upon evidentiary circumstances, difficult to define or catalogue in advance of the event" (pp. 240, 242).

All matters before the court below on the first review which either were decided or could have been decided are *res judicata.*[13] Consequently petitioners, contrary to their present contentions (Pet. Br. 75–80), are foreclosed from reopening, in this review, the validity of the system of accounts prescribed, the classification of the $3,500,000 item as a "write-up" in Account 107, or the authority of the Commission to order appropriate disposition of that amount. *Chicot County Dist.* v. *Bank,* 308 U. S. 371, 378; *American Surety Co.* v. *Baldwin,* 287 U. S. 156, 166–167; *Grubb* v. *Public Utilities Comm.,* 281 U. S. 470, 479; *Cromwell* v. *County of Sac,* 94 U. S. 351, 352. There thus remains for review merely the subject matter of the Commission's second order, which did no more than prescribe the method by which Northwestern should eliminate the "write-up" from Account 107, Electric Plant Adjustments. A similar limitation upon the jurisdiction of this Court equally follows from Section 313(b) of the Act.

Petitioners, however, in one guise or another, seek to raise now substantially all the points embodied or subject to decision in the first judgment of the court below, of which they did not see fit to seek review in this Court. Besides attacking the manner of disposition of the "write-up" pre-

[13] Petitioner Northwestern did not apply for certiorari to review the first decision of the court below, rendered February 13, 1942.

scribed in the second order, they question the authority of the Commission to apply its uniform system of accounts to Northwestern; to require the classification of "write-ups" in an adjustment account pending hearing and disposition; and to direct disposition after hearing. The action of the Commission, they state, viewed in its entirety, violates their rights under the Fifth Amendment, and also infringes upon the powers reserved to the states by the Tenth Amendment. We submit that these objections were correctly disposed of by the court below on the first review. In any event, we submit, these objections are without merit, for the reasons stated below.

I

Section 301(a) of the Federal Power Act Confers Comprehensive Accounting Authority Upon the Commission

The Federal Power Commission has been vested with comprehensive authority to establish and enforce uniform and correct accounting by public utilities subject to the Federal Power Act;[14] and this authority consequently justifies the account-

[14] A "public utility," as that phrase is used in the Federal Power Act, is "any person who owns or operates facilities" for the "transmission of electric energy in interstate commerce" and "the sale of electric energy" to any person for resale in "interstate commerce." Section 201. Cf. *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U. S. 61; *Hartford Electric Light Co.* v. *Federal Power Commission* (C. C. A. 2), 131 F. (2d) 953, certiorari denied, 319 U. S. 741.

ing orders issued to Northwestern. This is clear from (a) the unambiguous language of Section 301(a) of the Act; (b) the Federal Trade Commission's investigation and reports which revealed the accounting abuses in the utility industry and recommended to Congress the enactment of remedial legislation; (c) the legislative history of the Federal Power Act, which was the response to that recommendation; and (d) the judicial construction of Section 301(a) of the Act.

A. SECTION 301(A) OF THE FEDERAL POWER ACT IN UNAMBIGUOUS LANGUAGE CONFERS COMPLETE ACCOUNTING AUTHORITY UPON THE COMMISSION

Section 301(a) of the Act requires every "public utility" to "make, keep, and preserve" such "accounts, records of cost-accounting procedures, * * * memoranda, * * * books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this act * * *." Petitioners' contention (Pet. Br. 38–40) that the Commission's authority is limited to the prescription of memoranda accounts is rendered untenable by the authority in the Commission, under Section 301(a), to "prescribe a system of accounts to be kept by * * * public utilities" and after "notice and opportunity for hearing" to "determine by order the accounts in which particular outlays and receipts shall be entered, charged, or credited." More-

over, "the burden of proof to justify every accounting entry questioned by the Commission" is placed by Section 301 (a) upon the public utility, and the Commission is authorized to "suspend a charge or credit pending submission of satisfactory proof in support" of the entry.[15]

The only limitation on this grant of accounting authority appears in the text of Section 301 (a) itself:[16] the accounting system must be necessary or appropriate to the administration of the Act. There can be little doubt that the determination

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[15] Definition of the accounting terms in Section 301 (a) is left to the Commission, which is authorized by Section 309 to define, by its rules and regulations, the "accounting, technical and trade terms" used in the Act. Accordingly, contrary to petitioners' contention (Pet. Br. 39–40), there was no occasion for Congress to legislate in detail in an effort to anticipate every situation which might arise. See *Opp Cotton Mills* v. *Administrator*, 312 U. S. 126, 145.

[16] Petitioners contend (Pet. Br. 31–34) that Section 201 (a) of the Act, which provides that federal regulation is to extend to such matters only as are not subject to regulation by states, constitutes a limitation upon Section 301 (a). They consequently urge that Section 301 (a) is not applicable to Northwestern, insofar as its accounts are concerned, because its accounts are regulated by both the Oregon and Washington commissions. A cognate argument was rejected by this Court in *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U. S. 61, 74–75, 76, 77. The precise argument here made was likewise rejected by the Court of Appeals for the Second Circuit in *Hartford Electric Light Co.* v. *Federal Power Commission*, 131 F. (2d) 953, 964, certiorari denied, 319 U. S. 741. Any doubt in this respect would seem to be removed by the legislative history of Section 318 of the Act (see discussion *infra*, pp. 30–31).

of what is necessary or appropriate is a matter entrusted entirely to the Commission, subject to judicial control in case of clear abuse of discretion. The Commission's action in this delegated field of regulation cannot be scrutinized for error or unwisdom; it is only when no rational basis can be found to support the Commission's accounting rules and regulations that they may be set aside by the courts. *A. T. & T. Co.* v. *United States*, 299 U. S. 232, 236–237. The orders of the Commission here involved the uniform "system of accounts to be kept by" Northwestern, a public utility; and, after "notice and opportunity for hearing," the orders determined "the accounts in which particular outlays and receipts" (here, the fictitious receipt of $3,500,000 for common stock) "shall be entered, charged, or credited" (here, an entry to Account 107, coupled with annual charges to earned surplus). The appropriateness of such orders to the administration of the Act is patent from the breadth of the Commission's powers over public utilities (see pp. 41–44, *infra*).

B. THE LEGISLATIVE HISTORY OF THE ACT CLEARLY DISCLOSES THE INTENT OF CONGRESS TO CONFER COMPREHENSIVE ACCOUNTING AUTHORITY UPON THE COMMISSION

1. *The Federal Trade Commission's Investigation and Report*

In 1928, pursuant to Senate instructions (S. Res. No. 83, 70th Cong., 1st Sess.), the Federal

Trade Commission undertook a sweeping investigation of the public utility industry, which lasted seven years and resulted in a report to Congress consisting of 101 volumes (Sen. Doc. No. 92, 70th Cong., 1st Sess.). A separate investigation of the industry was conducted by the House Committee on Interstate and Foreign Commerce and its results were incorporated in the "Splawn Report" (H. Rep. No. 827, 73d Cong., 2d Sess.).

These investigations revealed numerous abuses in the public utility industry, including financial manipulation and exploitation, whereby the fixed assets of public utilities were written up or inflated, through one device or another, by approximately one and one-half billion dollars, such inflation being evidenced for the most part by the issuance of "watered" stock and the creation of fictitious surpluses (Sen. Doc. No. 92, Part 72–A, pp. 235–276, 282–293, 298–304; Part 73–A, p. 62). The report demonstrated that because fictitious and inflated costs were used to support higher rates, the inflation was detrimental to the consumer; and because the securities issued against the inflation were not supported by real assets, it was likewise detrimental to the investor (*id.* Part 72–A, pp. 299, 303). Moreover, the existence of this inflation in the utilities' plant accounts threatened the stability of the industry and had been largely responsible for the financial

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difficulties of many utility systems (*ibid.* p. 303). These evils were shown to have been due, in part, to deceptive and unsound accounting methods of utilities under which assets, liabilities, costs, operating results, and earnings were recorded in such manner that "write-ups" and inflation were covered up while unrealized and fictitious profits were made to appear genuine—methods which state regulatory bodies, because of constitutional limitations upon their regulation of interstate commerce, were powerless to prevent or correct (*id.* Part 73–A, pp. 62–64).

In order to correct the financial manipulation of the past and to prevent its repetition in the future, the Trade Commission recommended that Congress enact remedial legislation directed against the abuses disclosed. To restore "soundness and common honesty in corporate and particularly in holding-company affairs" and in the interest of "proper accounting with respect to the values of assets, whether in plant or in security investments, and also with respect to actual income and net profit," the Trade Commission specifically recommended that an appropriate agency be given "power to make and enforce regulations as to uniform accounting" (*ibid.* pp. 65, 74). It pointed to the necessity of comprehensive regulation of utility accounting by the Federal Government if the "water" was to be

removed from electric utility plant accounts."[17] That a situation such as in the case at bar was comprehended by the Trade Commission is removed from the realm of conjecture by the specific mention made of the instant "write-up" as an illustrative evil.[18]

2. *The Federal Power Act*.

As a result of the information contained in the Trade Commission's report and the Splawn report, and the recommendations of the former for remedial legislation, Congress undertook the consideration of appropriate legislation and eventually passed the Public Utility Act of 1935 (49 Stat. 803).[19] Title I thereof (known as the "Pub-

[17] "The present study teaches that the way to effective regulation of that phase of the public-utility operations having to do with security issues and the maintenance of a proper balance between capitalization and the actual capital or money investment necessary to produce the service is a long, arduous one to travel, and, if left entirely to the regulatory venture of the several States, it is more than doubtful that it will ever lead to the realization of the goal of effective regulation" (*ibid.* Part 73-A, pp. 109, 139).

[18] The Federal Trade Commission Report (Part 35) discussed the accounting entries relating to the $10,000,000 common stock of Northwestern, involved in this proceeding, and concluded that "it appears that the book value of the property at that time was *inflated 100 per cent* in order to take care of stock actually issued without tangible consideration" (p. 155) (italics supplied).

[19] S. 2796, 74th Cong., 1st Sess. Predecessor bills were H. R. 5423, and the companion Senate bill, S. 1725 (S. Rep. No. 621, 74th Cong., 1st sess., p. 1).

lic Utility Holding Company Act of 1935") confers on the Securities and Exchange Commission certain jurisdiction over holding companies and their subsidiaries. Titles II and III confer upon the Federal Power Commission regulatory power over electric utilities operating in interstate commerce.

Witnesses at the hearings, including representatives of the utility industry, emphasized the importance of uniform and sound accounting authority as an aid to the elimination of past abuses and the prevention of their recurrence (Hearings before House Committee on Interstate and Foreign Commerce, on H. R. 5423 (74th Cong., 1st Sess.), pp. 345, 807, 809, 1106–1107, 1307–1308, 1920). There was testimony that sound accounting alone was sufficient to cure the abuses (*id.* pp. 919, 1343), and the report of the Senate Committee on Interstate Commerce stated categorically that "The authority of the Commission over the accounts of companies under its jurisdiction extends to the entire business of such companies." (S. Rep. No. 621, 74th Cong., 1st Sess., p. 53).[20] The importance attached to the accounting powers by Congress is emphasized by the unsuccessful attempt which was made to limit the federal accounting authority conferred by the Act, taking

[20] See also H. Rep. No. 1318, (74th Cong., 1st Sess.), pp. 30–31.

the form of a provision (Section 318 (b)) that "If, with respect to * * * the method of keeping accounts * * * any person is subject to the law of any State or regulation by a State commission, such person shall not be subject to the requirements of this part or the next preceding part * * * with respect to the same subject matter." Although it was adopted in the House (79 Cong. Rec. 10574–10575), the Conference Committee eliminated it (Conference Report, H. Rep. No. 1903 (74th Cong., 1st Sess.), pp. 63, 75).[21]

[21] Representative Lea, a member of the House Committee on Interstate and Foreign Commerce which reported the bill, objected to the amendment on the following grounds:

"* * * It [the amendment] would largely destroy the usefulness of the Federal regulation this bill gives to the Federal Power Commission. We cannot have effective regulation unless we give that Commission the power to get information and give it control over accounts and valuations. The amendment * * * would destroy effective control over the accounts * * * of these utility companies. It would compel the Federal Government to accept State valuations, made in some instances without adequate information and sometimes in total disregard of the rights of the people of other States whose interests, rates, investors, and consumers are involved. * * *

"So I sincerely hope the Members of the House who are about to pass a bill that will tend greatly to remedy the evils that have been inflicted upon the country in recent years will not in the closing sections of this bill adopt an amendment which will cripple the usefulness of the Federal power commission in attempting to carry on the important work we are about to assign it" (79 Cong. Rec., pp. 10574–10575).

C. THE JUDICIAL CONSTRUCTION OF SECTION 301 (A) ACCORDS COMPLETE ACCOUNTING AUTHORITY TO THE COMMISSION

Every decision which has considered Section 301 (a) supports the view that it constituted a grant of plenary accounting authority to the Federal Power Commission. While the precise question of the scope of the accounting authority was not there involved, this Court stated in *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U. S. 61, 73, n. 12, that the control of the Commission over records and accounts under Section 301 (a) is complete. In the first review of the instant case by the court below (4 R. 815, 125 F. (2d) 882, 886), it was held that the accounting authority of the Commission was unlimited. See also *Hartford Electric Light Co.* v. *Federal Power Commission*, 131 F. (2d) 953, 964 (C. C. A. 2), certiorari denied, 319 U. S. 741.

Decisions dealing with licensees under Part I of the Act are to the same effect. In *Alabama Power Co.* v. *Federal Power Commission*, 128 F. (2d) 280, 285–286 (App. D. C.), certiorari denied, 317 U. S. 652; *Louisville Gas & Electric Co.* v. *Federal Power Commission*, 129 F. (2d) 126, 133–134 (C. C. A. 6), certiorari denied, 318 U. S. 761; and *Northern States Power Co.* v. *Federal Power Commission*, 118 F. (2d) 141, 144 (C. C. A. 7), the summary and sweeping effect of the Commission's accounting power was upheld. More particularly, the courts of appeals in those three cases upheld

the Commission's power to order licensees to remove from their electric plant accounts certain items found by the Commission not to be actual legitimate original costs of the project, and to charge these items to earned surplus.[22] The authority of these cases is not diminished for present purposes because they involved licensees instead of public utilities, for the only accounting authority over either is that conferred by Section 301 (a), and no distinction is made either in that section or elsewhere in the Act between the authority of the Commission over accounts of licensees and its authority over those of public utilities.

We accordingly submit that Section 301 (a) was a grant of plenary accounting authority to the Federal Power Commission.

II

The Commission Is Authorized To Prescribe a Uniform System of Accounts Upon the Basis of Cost and To Require the Segregation and Disposition of "Write-Ups"

Following the passage of the Federal Power Act of 1935, the Commission undertook the prep-

[22] A similar order of the Commission was affirmed on the authority of these cases in *Pennsylvania Power & Light Co.* v. *Federal Power Commission*, C. C. A. 3, decided December 7, 1943, not yet reported, and similar orders were affirmed without discussion in *Niagara Falls Power Co.* v. *Federal Power Commission*, 137 F. (2d) 878 (C. C. A. 2), certiorari denied, November 22, 1943, October Term, 1943, No. 448, and *Puget Sound Power & Light Co.* v. *Federal Power Commission*, 137 F. (2d) 701 (App. D. C.).

aration and promulgation of its uniform system of accounts. In close cooperation with a committee of the National Association of Railroad and Utilities Commissioners (N. A. R. U. C.) and other state and federal agencies, a tentative draft of the accounting system was prepared and submitted to the state commissions and to representatives of electric utilities. After receipt and consideration of all views and criticisms, the Commission prescribed its "Uniform System of Accounts for Public Utilities and Licensees," effective January 1, 1937 (3 R. Ex. 6).[23] Federal Power Commission, *Sixteenth Annual Report to Congress* (1936), pp. 9–11.

Under this system, the amounts to be reflected in the electric plant accounts are limited to actual cost without any provision for fluctuations of value. The actual cost of the utility's electric plant is recorded in Account 100, "Electric Plant," which is the first account on the balance sheet (See Appendix B, p. 87, *infra*). Amounts

[23] At approximately the same time, the N. A. R. U. C. adopted a uniform system of accounts almost word for word the same as the Commission's, endorsed the Commission's system to the State commissions, and recommended the use of either the Commission's or the N. A. R. U. C.'s system. Of the 42 state regulatory commissions having jurisdiction over electric companies, 16 have prescribed the Power Commission's, 20 have prescribed the N. A. R. U. S.'s, and the remaining 6 have prescribed modifications of the two systems. Moody's *Public Utilities* (1943), page a38.

on the books of the utility in excess of such actual costs (i. e., "write-ups" and other erroneous items) must be transferred to the second account, namely, Account 107, "Electric Plant Adjustments," where they become subject to disposition as the Commission "may approve or direct." Unlike Northwestern, which constructed all of its electric properties (1 R. 217, 288), many utilities have acquired properties as operating units or systems from persons who had previously devoted them to public service. Such utilities, again unlike Northwestern, are subject to the further requirement, under the System of Accounts, of breaking down the actual costs in Account 100, "Electric Plant," to show the original cost of the properties acquired; that is, the cost of such properties to the person first devoting them to public service. Such original cost is classified in Account 100.1, "Electric Plant in Service," and the difference between actual cost to the accounting utility and original cost is recorded in Account 100.5, "Electric Plant Acquisition Adjustments," with a showing as to the nature of the excess: i. e., whether it represents going value, structural value, etc.[24] These amounts are thereafter to be "depreciated, amortized, or otherwise

[24] Account 100.1 and Account 100.5 are subdivisions of Account 100. These subaccounts appear in the books of the utility but not in the balance sheet. Account 100 alone appears in the balance sheet, reflecting the sum total of these subaccounts.

disposed of, as the Commission may approve or direct" in the light of their nature and the applicable legal and accounting principles[25] (3 R. Ex. 6, p. 19), after notice and opportunity for hearing (1 R. 339–340).[26]

In *A. T. & T. Co.* v. *United States*, 299 U. S. 232, this Court was concerned with the disposition to be made of the difference between original cost and actual cost which was classified in an adjustment account similar to Account 100.5. The problem presented in that case with reference to such an account is not involved here, since Northwestern, as above stated, constructed all of its properties and the actual cost of such properties to it is the same as original cost (1 R. 217, 288, 343). The $3,500,000 item in this proceeding has been classified as a "write-up" in Account 107 and does not represent any cost to Northwestern.

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[25] The provisions of Account 100.5 and Account 107 of the Commission's System of Accounts (3 R. Ex. 6, p. 19) are contained verbatim in the N. A. R. U. C. System of Accounts.

[26] As of June 30, 1943, reclassifications and original cost studies have been filed by 281 companies in which they have classified $516,397,832 in Account 100.5 and $239,492,266 in Account 107, an excess of 11.65% over original cost of $6,487,567,327. Commission staff audits of 75 companies as of June 30, 1943, have resulted in the classification by the staff of $73,010,669 in Account 100.5 and $448,891,667 in Account 107, or an excess of 26.16% over aggregate original cost of $1,994,972,014. As of October 26, 1943, the Commission approved or directed disposition of "write-ups" aggregating $368,314,153 (*The Financial Record of the Electric Utility Industry*, 1937–1942, p. 3, Federal Power Commission).

In summary, the prescribed system of accounts is uniform; is mandatory on all "public utilities"; requires that fixed assets be reflected at cost; prohibits the recording of fluctuations in value; and requires that all "write-ups" be placed in an adjustment account No. 107, thereafter to be disposed of in the manner which the Commission approves or directs.

A. A UNIFORM SYSTEM OF ACCOUNTS, BASED UPON COST, IS NECESSARY AND APPROPRIATE IN CARRYING OUT THE PURPOSES OF THE ACT AND THE COMMISSION'S DUTIES THEREUNDER

As already shown (pp. 24–26), Section 301(a) of the Act confers comprehensive authority upon the Commission to prescribe whatever system of accounts it may find to be "necessary or appropriate for purposes of the administration of this Act."[27] The limits of judicial power in reviewing such accounting regulations have been defined by this Court in *A. T. & T. Co. v. United States*, 299 U. S. 232, 236–237, as follows:

> This court is not at liberty to substitute its own discretion for that of administra-

[27] Since the words "necessary" and "appropriate" are stated in the disjunctive, it is of course sufficient to support the exercise of the accounting power that it be shown to be either appropriate or necessary. Accordingly, our use of the word "appropriate" is not to be taken to mean that it is not also necessary.

tive officers who have kept within the bounds of their administrative powers. To show that these have been exceeded in the field of action here involved, it is not enough that the prescribed system of accounts shall appear to be unwise or burdensome or inferior to another. Error or unwisdom is not equivalent to abuse. What has been ordered must appear to be "so entirely at odds with fundamental principles of correct accounting" (*Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423, 444) as to be the expression of a whim rather than an exercise of judgment. *Norfolk & Western Ry. Co.* v. *United States*, 287 U. S. 134, 141; *Kansas City Southern Ry. Co.* v. *United States, supra*, p. 456. Then too, in gauging rationality, regard must steadily be had to the ends that a uniform system of accounts is intended to promote. "The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is not to enable it to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction." *Interstate Commerce Comm'n* v. *Goodrich Transit Co.*, 224 U. S. 194, 211; *cf. Kansas City Southern Ry. Co.* v. *United States, supra*, p. 445. With these principles in mind, we proceed

to consider separately the regulations and instruction now challenged as unlawful.

In the light of the results sought to be achieved by the Act (see pp. 29–31, *supra*) and of the duties imposed upon the Commission thereunder, we submit that the Commission was clearly within its authority in prescribing its uniform system of accounts.

This Court has long recognized, in the field of interstate carriers, "that no system of supervision and regulation would be complete without requiring the accounts of all the carriers to speak a common language." *Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423, 443. Otherwise, the companies' accounts would not provide a "basis for comparison of their respective operations." *Norfolk & Western Ry. Co.* v. *United States*, 287 U. S. 134, 140. The same need for uniformity in public utility accounting was disclosed in the Federal Trade Commission's investigation (see pp. 26–29, *supra*). The investigation brought out the facts—confirmed by the experience of the Power Commission—that utilities buried inflation in their accounts; they frequently carried their electric plant accounts in a lump sum, so that it was impossible to ascertain the investment applicable to generating stations, transmission lines, and other specific items of electric plant; and they carried purchases of property made many years before in one account from year

to year without change in the amount recorded.[25] These conditions, unless corrected, would seriously interfere with the performance of the Commission's duties under the Act; and their correction required that a uniform system of accounts be prescribed. This was indeed the opinion of Northwestern's own expert accounting witness, Bell, who testified in the instant case that it was necessary to standardize the accounts to permit ready comparisons between companies (1 R. 177). Petitioners do not question the propriety of a system of accounts applicable uniformly to all "public utilities," nor can there be any objection to such uniformity.

There is as little justification for any attack against the predication of the Commission's Uniform System of Accounts upon a cost basis. Cost is the fundamental basis of accounting for utility plant, and the accounting systems prescribed by both federal and state regulatory agencies invariably have been based upon the cost principle. (Pertinent excerpts from the system of accounts promulgated by the Interstate Commerce Commission, the Federal Communications Commission, the Oregon Commissioner, the Public Service Department of Washington, and other agencies, are set forth in Appendix C, pp. 89–96,

[25] Federal Power Commission, *Twentieth Annual Report to Congress* (1940), p. 53; 1 R. 336–337; Sen. Doc. No. 92 (70th Cong., 1st Sess.), Part 72–A, pp. 799–800.

infra).[29] The functions explicitly vested in the Commission by the Act leave no room for doubt as to the appropriateness of a system of accounts based on cost.

(1) The Commission is specifically authorized to "investigate and ascertain the actual legitimate cost of the property of every public utility" and to require it to file a statement "of the original cost" of its property (Sec. 208). Such a requirement alone in an analogous act has been held suf-

[29] At the hearings before the House Committee on Interstate and Foreign Commerce, Commissioner Seavey, analyzing Title II of H. R. 5423, proposed by the Federal Power Commission, pointed out that the section vesting accounting authority in the Commission "is in substance the same as the provisions of the Interstate Commerce Act applicable for many years to telegraph and telephone companies and reenacted in the Communications Act passed by the last Congress." (Hearings on H. R. 5423 before the House Committee on Interstate and Foreign Commerce (74th Cong., 1st Sess.), Pt. 1, p. 386). To the same effect is the testimony of Dozier A. DeVane, Solicitor of the Commission, before the Senate Committee on Interstate Commerce in the hearings on the companion bill, S. 1725 (74th Cong., 1st Sess.), p. 248. The statements of Commissioner Seavey and of Mr. DeVane acquire added significance from the fact that the accounting regulatory provisions in the bills proposed by the Commission, to which the statements related, were accepted by Congress and enacted into law in substantially the same form as recommended by the Commission, although other provisions were changed. Cf. Secs. 211 and 301 of H. R. 5423 (Hearings before the House Committee on Interstate and Foreign Commerce (74th Cong., 1st Sess.), Pt. 1, pp. 35, 37) and S. 1725 (Hearings before the Senate Committee on Interstate Commerce (74th Cong., 1st Sess.), pp. 43, 44–45) with Secs. 208 and 301 of the Act as adopted.

ficient to support an original cost system of accounts. *A. T. & T. Co. v. United States*, 299 U. S. 232, 244–245.

(2) The Commission is authorized to require every public utility to file periodic and special reports giving full information as to "assets and liabilities, capitalization, *net investment*, and reduction thereof, gross receipts, interest due and paid, depreciation and other reserves, *cost of project and other facilities*" and to require the utility "to make adequate provision for currently determining such costs and other facts" (Sec. 304 (a)). [Italics supplied.]

(3) The Commission's regulation of rates under Section 206 (a) of the Act is largely, if not entirely, dependent upon each utility's complying with a Uniform System of Accounts based upon cost. The original cost of a utility's property is, admittedly, a major factor in fixing the rate base (*Los Angeles Gas Co.* v. *R. R. Commission*, 289 U. S. 287, 307). Moreover, it is essential that the utility's accounts be stated on a cost basis if the amounts to be allowed for operating expenses, including depreciation, are to be determined accurately and expeditiously;[20] and determination of net income is likewise dependent upon the appropriateness of these charges. An essential element in fixing the rate of return is the cost of money

[20] See Morehouse, *Innovations in Public Utility Accounting Regulation* (1937), 46 Yale L. J. 955, 968.

to the utility and such cost is directly affected by the financial structure which in turn is related to its soundness of its accounting practices. *Bluefield Co. v. Public Service Comm.*, 262 U. S. 679, 692–693. "Watered" plant almost always means "watered" securities.

(4) The Commission is even more dependent upon its cost system of accounts in determining, under Section 205 of the Act, whether rate increases proposed by the utilities should be permitted to take effect without suspension and investigation. Under the statute, the Commission must make this determination within thirty days after the proposed rate increase is filed. It is only by reason of the cost data made available under the system of accounts that the Commission is able to discharge this responsibility, since the time allowed and the volume of such filings preclude extended investigations.

(5) Section 311 of the Act authorizes and directs the Commission, as a basis for recommending legislation to Congress, to secure and keep current information with respect to "the cost of generation, transmission, and distribution" of electric energy throughout the United States, and relation of such costs to the development of navigation, commerce, and the national defense. The duty to make reports to Congress of itself would justify promulgation of a uniform system of accounts based on cost. Cf. *Interstate Commerce*

Commission v. *Goodrich Transit Co.*, 224 U. S. 194, 208–211.

(6) The data made available under the Commission's system of accounts are likewise essential in its regulation of mergers and consolidations and the acquisition of securities under Section 203 (a) of the Act. Cf. *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U. S. 61.

A corollary of the predication of the Commission's system upon cost is its exclusion of fluctuations in the value of electric plant (3 R. Ex. 6, p. 19). The system would, indeed cease to be based on cost if it permitted fluctuations in plant values to be recorded in the accounts, for the realistic and readily ascertainable items of cost would be submerged in the conjectural and illusory estimates of value.[51] Any attempt to make the accounts reflect current values is both inexpedient and impractical. American Institute of Accountants, *Research Bulletin No. 5* (April 1940), pp. 37, 39. Revaluations "inject a disturbing element into accounts; they destroy comparisons and tend to reduce the acceptability of the balance-sheet generally." Sanders, Hatfield and Moore,

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[51] See the discussion of "cost" vs. a "fair value" rate base, and the vices in "reproduction new" as a rate base, in brief for the Federal Power Commission in *Federal Power Commission* v. *Hope Natural Gas Co.*, Nos. 34 and 35, this Term, pp. 53–70, and Supplement to Brief, pp. 2–67.

A Statement of Accounting Principles (1938), p. 63. If accounts were required to be kept according to the "fair value" principle, then during the depression of the 1930's many, if not most, business enterprises would have suffered capital impairments requiring reorganizations.[32] To permit the inclusion of amounts in excess of cost on the protean theory of appreciation in the value of electric plant would defeat the purposes of the system of accounts, especially its prime objectives of uniformity and comparability. The Uniform System of Accounts, based on cost and making no provision for appreciation in value of electric plant, is therefore, we submit, both necessary and appropriate for the proper performance of the Commission's functions under the Act. Because of its direct bearing upon such functions, the prescription of the System represents a proper and rational exercise of the Commission's administrative judgment and discretion, and is entirely consistent with "fundamental principles of correct accounting." There is consequently no warrant for judicial disapproval of the system. Cf. *A. T. & T. Co. v. United States*, 299 U. S. 232, 236–237.

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[32] Moreover, "such changes in price levels as have occurred in this country during the last half century have afforded insufficient reason for the adjustment of asset values." *Accounting Principles Underlying Corporate Financial Statements*, American Accounting Association (June 1941), p. 4.

B. THE COMMISSION IS AUTHORIZED TO REQUIRE THE SEGREGATION AND DISPOSITION OF "WRITE-UPS"

As already stated, the Commission's Uniform System of Accounts requires each "public utility" to reclassify its accounts to show the cost of its electric plant in certain accounts and to segregate "write-ups" and other items not representing actual cost in Account 107, "Electric Plant Adjustments," for such disposition as the Commission may approve or direct. Petitioners do not affirmatively contend that the Commission exceeded its authority in requiring the reclassification on the basis of cost and the transfer of all items not representing cost to an adjustment account, nor would such a contention be tenable, for the accounting classifications to be made and the items to be entered under each classification are peculiarly matters for the Commission's determination. *Norfolk & Western Ry. Co.* v. *United States*, 287 U. S. 134, 141, 143. The creation of Account 107 and the mandatory inclusion of "write-ups" therein were therefore clearly within the province of the Commission.

That the $3,500,000 item here involved was properly classified as a "write-up" in Account 107, "Electric Plant Adjustments," cannot be disputed. The history of the common stock discloses that it was issued without consideration, and that its issuance amounted to "manipulation," as the Commission aptly characterized it (1 R. 62). The

Commission hence properly found that the balancing entry on the asset side constituted a "write-up"; and petitioners do not appear to question that it may so be accepted for the purposes of this case (cf. Pet. Br. 15).

As the text of Account 107 makes clear, items classified in that account cannot remain there permanently and are subject to disposition as the Commission may approve or direct (3 R. Ex. 6, p. 19). The Commission's comprehensive authority under Section 301 (a) of the Act, to "prescribe a system of accounts to be kept" by every public utility and to "determine by order the accounts in which particular outlays and receipts shall be entered, charged, or credited" is in itself sufficient to sustain the power to require disposition of improper items included in the accounts. Otherwise, the authorization in Section 301 (a) is rendered virtually meaningless, for erroneous entries, inflationary and otherwise, after being detected by the Commission would continue in the accounts under merely a different heading.[33]

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[33] In *Long Beach Gas Co.* v. *Maltbie*, 36 N. Y. S. (2d) 194, affirmed, 290 N. Y. 572, the court upheld the authority of the Public Service Commission of New York to require disposition of improper charges in the company's fixed capital accounts, under accounting authority expressed in language almost identical with that employed in Section 301 of the Federal Power Act (New York Public Service Law, Article 4, Sec. 66 (4), and 66 (9)). The Appellate Division said:

"Assuming that the Phillips fee was correctly found to be an improper charge then any argument that the Commission

In this proceeding two of the Commission's principal accounting officers testified, without contradiction, that sound principles of accounting required that the "write-up" be removed from the books of the company (1 R. 361–362, 488–489). See *Alabama Power Co.* v. *Federal Power Commission*, 128 F. (2d) 280, 294–295 (App. D. C.), certiorari denied, 317 U. S. 652; *Louisville Gas & Electric Co.* v. *Federal Power Commission*, 129 F. (2d) 126, 133 (C. C. A. 6), certiorari denied, 318 U. S. 761. The *amicus* brief of the American Institute of Accountants, filed herein, also accepts this view for the purpose of its brief (pp. 3, 6).[24] Petitioners have not offered expert testimony or cited accounting authority to the contrary.

The elimination of "write-ups" from the asset accounts is clearly essential to a proper discharge by the Commission of its statutory responsibilities with respect to depreciation of utility properties.

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lacks power to direct its elimination must necessarily rest solely on the fact that it has been entered in a capital account and paid. If a limitation exists on any such basis as that, then the power of the Commission to regulate is largely fictitious. With affiliates and interdependent utilities involved capital values might be loaded with improper expenditures and built up to any figure, however preposterous, and under such a theory the Commission would be powerless to interfere. We decline to accept such a theory, and in our opinion the Commission had authority under the statute to make the direction attacked" (p. 204).

[24] The Institute's reference to Paton, *Advanced Accounting* (1941), pp. 508–509, indicates that it may possibly have misconceived the problem here presented. The cited passage refers to method of disposition of discounts on the sale of common stock.

Section 302 (a) of the Act confers plenary and exclusive authority upon the Commission to determine the rates of depreciation to be charged upon the various classes of such properties and prohibits any utility from charging depreciation on any class of property or at any rate other than that prescribed by the Commission. Depreciation, of course, cannot be based upon "write-ups," since these items do not represent any investment in the company's properties. The Commission's Uniform System of Accounts accordingly does not permit depreciation to be charged on "write-ups" classified in Account 107 (3 R. Ex. 6, p. 33).[35] On the other hand, all of the company's electric plant, other than land which is not involved here, is necessarily subject to depreciation or amortization and must therefore ultimately disappear from the asset accounts.[36] Unless the "write-ups" in Account 107 are disposed of in some orderly fashion, they, unlike the actual investment which the company has made in depreciable plant properties, would remain on the books permanently.

Moreover, it is essential to dispose of a "write-up" because if it "is not charged off in one way

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[35] The difference between actual cost and original cost, included in Account 100.5, like the amounts included in the adjustment account in *A. T. & T. Co.* v. *United States*, 299 U. S. 232, 242–244, is subject to depreciation or amortization (3 R. Ex. 6, pp. 33, 39).

[36] *Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423, 448; *Knoxville* v. *Water Co.*, 212 U. S. 1, 13.

or the other it remains as a permanent inflation of the property accounts, and tends to produce, directly or indirectly, a declaration of dividends out of capital." *Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423, 456. The Act makes it "unlawful for any officer or director of any public utility * * * to participate in the making or paying of any dividend of such public utility from any funds properly included in capital account." (Sec. 305 (a).) This prohibition undoubtedly places a definite limitation upon the right to declare dividends where the capital is impaired, and since the supervision of enforcement of that provision is entrusted to the Commission (Sec. 314), it must adopt means readily to ascertain whether dividends have been paid from capital and whether such payment was knowingly made by any officer or director. (See Sec. 316.) The requirement that the books of account of a public utility accurately reflect the standing of its capital is a reasonable if not an essential means of determining whether the mandate of Section 305 (a) is being observed.[37]

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[37] Section 305 (a) of the Federal Power Act had its origin in Section 212 of the Federal Communications Act of 1934 (47 U. S. C. 212). Section 212 of the Communications Act in turn was taken from Section 20a (12) of the Transportation Act of 1920 (49 U. S. C. 20a (12)). Hearings before H. Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., p. 16; H. Rep. No. 1850, 73d Cong., 2d Sess., p. 6; S. Rep. No. 781, 73d Cong., 2d Sess., p. 4; S. Rep. No. 621, 74th Cong., 1st Sess., p. 53; Hearings before

These considerations, we submit, require the conclusion that the Commission, under its comprehensive accounting authority, properly prescribed its Uniform System of Accounts based on cost, with "write-ups" classified and marked for disposition; and that the $3,500,000 item here in question was properly determined to be a "write-up" of which some form of disposition should be made.

III

The Commission Properly Required Disposition of the $3,500,000 "Write-Up" by Annual Charges to Surplus

While conceding that the classification of the $3,500,000 "write-up" in Account 107, "Electric Plant Adjustments," is permissible for purposes of identification, petitioners contend that Northwestern is entitled to retain the item in that account unless it can be shown to be in excess of the "present value" of Northwestern's properties (Pet. Br. 49).

The accounts in which Northwestern previously carried the item in question were "Land and Water Rights," "Miscellaneous Non-Operating Intangible Capital" and "Organization," and the impropriety of carrying a conceded "write-up" in

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S. Committee on Interstate Commerce, 74th Cong., 1st Sess., p. 248; Hearings before H. Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess., p. 387. So far as we are able to discover, there has been as yet no judicial or administrative interpretation of this prohibition.

any of these accounts has been demonstrated. Nor can it find placement in any other prescribed account on the asset side. Petitioners' contention that the "write-up" may be retained on the asset side of the balance sheet would therefore require the creation of a new account reflecting present value in excess of actual cost, which would in effect be only a plant appreciation account.

Such an account has no place in a cost system of accounting, and the system prescribed by the Commission specifically forbids the recording therein of appreciation of electric plant (3 R. Ex. 6, p. 19). Indeed, petitioners' own contention does not bear analysis, for it seeks to include appreciation of electric plant on its books of account, not for the purpose of having them show the actual alleged appreciation in value, but rather to show appreciation only in an amount sufficient to equal the "write-up" and thus preclude its being charged off.

The authority of the Commission to prescribe a system of accounts based upon cost was upheld by the court below on the first appeal (4 R. 814–818), a decision of which Northwestern sought no further review. Northwestern has always been required to record its utility plant at cost (1 R. 184, 219),[38] and has failed to present any satisfactory

[38] Under the 1913 Oregon system of accounts, to which Northwestern was subject in 1914 when it first recorded the

reason for a partial exception in its case from a system of accounts uniformly prescribed for all utilities.

A. THE METHOD OF DISPOSITION ORDERED BY THE COMMISSION WAS APPROPRIATE

Northwestern was apprised by order of the Commission that the $3,500,000 was to be transferred to Account 107, thereafter to be disposed of as the Commission should approve or direct. The Company's objection to this order was overruled by the Commission, and the order was approved by the court below. The company had been given an opportunity at the original hearing to propose a method for disposing of the "write-up," but failed to avail itself thereof. The Commission in its first order accordingly directed its disposition by annual charges against surplus. Upon the objection of Northwestern to this direction, the Commission granted it a rehearing at which it was given another opportunity to suggest an alternative method of disposition. Petitioners declined

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common stock item on its books, the charges to the fixed capital accounts had to be "the actual money cost of the property" and where the consideration given for property was other than money, the charge had to be the "actual money value of such consideration at the time of the transaction" (2 R. 631). Northwestern's witness Platt admittedly was not "prepared to state the value on a cash basis of the 100,000 shares of stock at the time of the transaction" (2 R. 562).

to do so,[39] but instead elected "to challenge" the "powers" of the Commission. They must therefore abide the consequences of such a course of conduct, having voluntarily foregone "the opportunity to question the propriety" of the method of disposition ordered: *Alabama Power Co.* v. *Federal Power Commission*, 128 F. (2d) 280, 295, 296 (App. D. C.), certiorari denied, 317 U. S. 652.

The Commission, confronted by the necessity of ordering some disposition of the "write-up" and receiving no suggestions from petitioners other than retention, directed that Northwestern each year "credit Account 107, Electric Plant Adjustments, and charge Account 414, Miscellaneous Debits to Surplus, with a sum equal to its Net Income (Account 400, Credit Balance Transferred from Income Account) less its Preferred Stock Dividend requirements" until the amount of $3,500,000 shall have been entirely extinguished[40] (5 R. 1173).

[39] Counsel for Northwestern made the following statement in this respect at the oral argument before the Commission (5 R. 1080):

"As I made clear in the discussion during the record, our only plan of disposition, if you want to call it that, was one of indisposition to do anything about it. In other words, our plan of disposition was a plan of retention, of keeping that there, which is our position now, that that is an asset, that there are assets that we value on the asset side of the balance sheet to match the liabilities, including the three and a half million dollars that is on the other side."

[40] A potential method of disposition would be a write-off against capital surplus. Since Northwestern had no existing capital surplus, it would have been necessary for petitioners to create such capital surplus and they made no offer in that respect.

This order was unquestionably proper. It was the uncontroverted expert opinion of two of the Commission's principal accounting officers that the "write-up" could be eliminated from Account 107 either by an immediate charge to earned surplus, or by a series of annual charges thereto over a period of years (1 R. 361–362, 488–489). The Commission, after consideration of all relevant factors, including "the interest of consumers, investors and the public" (1 R. 69), selected the latter alternative and ordered Northwestern to eliminate the "write-up" by charging its earned surplus account each year with an amount equal to the excess of its net income over its preferred stock dividend requirements.

There is no contention here that the utilization of earned surplus for the elimination of the "write-up" does not accord with correct principles of accounting.[41] The contention is made,

[41] Nor could there be. Surplus is the accounting mechanism used to balance both sides of the balance sheet, and the removal of the inflation necessarily requires a complementary or balancing charge reducing the surplus account. This is supported by the record (1 R. 361–362, 488–489), by the textbook writers (Finney, *Principles of Accounting* (1934), Vol. I, pp. 79–80; Kester, *Advanced Accounting* (3rd rev. ed., 1933), pp. 541–542; Saliers and Holmes, *Basic Accounting Principles* (1937), p. 435), and by the judicial authorities (*Long Beach Gas Co.* v. *Maltbie*, 36 N. Y. S. (2d) 194, 203–204, affirmed, 290 N. Y. 572; *Alabama Power Co.* v. *Federal Power Commission*, 128 F. (2d) 280, 294–295 (App. D. C.), certiorari denied, 317 U. S. 652; *Northern States Power Co.* v. *Federal Power Commission*, 118 F. (2d) 141 (C. C. A. 7); and *Louisville Gas & Electric Co.* v. *Federal Power Commission*, 129 F. (2d) 126 (C. C. A. 6), certiorari denied, 318 U. S. 761).

however, that sound accounting principles require the immediate elimination of the "write-up" by a single charge to earned surplus, regardless of the consequences (Pet. Br. 63–64; *Amicus* Brief, 4, 6). It is said that no principle of accounting countenances the method of amortization of the "write-up" here prescribed and that, therefore, the Commission's order may not be sustained on accounting grounds (Pet. Br. 63–64; *Amicus* Brief, 4, 6).[42] Petitioners conclude that this invalidates the Commission's order as "arbitrary" (Pet. Br. 64), but the *amicus curiae* merely urges (p. 6) "that if the order is sustained such a decision be promulgated as one based on considerations other than principles of accounting."

These objections are without merit. The record supports the mode of disposition ordered, and if

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[42] The *Amicus* Brief does not suggest that proper accounting permits the retention of the "write-up" or that the "write-up" should not be completely eliminated. It suggests, however (p. 4), that under the Commission's order elimination of the "write-up" is not definitely assured at any specific date because of such elimination's dependence upon adequate earnings. However, based upon past operations of the company, it was reasonable to expect that future conditions would permit elimination of the "write-up." From the effective date of the Commission's order through 1942, $639,916 has become available for this purpose. (*Financial Statistics for Electric & Gas Subsidiaries of Registered Public-Utility Holding Companies*, 1930–1942, Report of Public Utilities Division, Securities and Exchange Commission, p. 29). Moreover, if conditions subsequently indicate that some modification of the amortization plan should be made, the Commission could take appropriate action.

petitioners preferred the alternative method of a single charge, they should have availed themselves of the opportunity afforded them to request and support it. The Commission can scarcely be criticized when, at the obstinate refusal of petitioners to crystalize their objections in the form of helpful suggestions, it proceeded to select a method of annual charges which it found to be fair to consumers, investors and the public—a method which might normally be regarded as more palatable to the utility than an immediate charge-off of the entire "write-up."

Petitioners also contend that the Commission's order of disposition represents an undue interference with management (Pet. 30). But any regulation interferes with management, and such interference is not *ipso facto* a ground for invalidation of regulation. Cf. *Norfolk & Western Ry. Co. v. United States*, 287 U. S. 134, 143. And where management abdicates its responsibility, as here, by refusing either to act or to suggest permissible action, the Commission's action can scarcely be called an undue interference with it. Petitioners' failure to develop this question, suggested in their petition (p. 30), may be a present recognition of its unsubstantiality.

Equally devoid of substance is petitioners' further contention (Pet. Br. 50) that the disposition ordered effects a reorganization, or at least a quasi-reorganization, of Northwestern, and that this requires consideration of value. A reorgani-

zation usually involves a complete rehabilitation of an enterprise, including readjustment, suspension, or alteration of some or all existing legal interests in the business and property of stockholders and creditors. Finletter, *The Law of Bankruptcy Reorganization* (1939), p. 556; Fletcher, *Cyclopedia of Corporations*, Perm. Ed. Vol. 15, pp. 318–322. A quasi-reorganization involves a write-down of the capital stock of the company to create a capital surplus against which amounts on the asset side may be charged (see note 40, *supra*). American Institute of Accountants, *Accounting Research Bulletin No. 3*, September 1939; *S. E. C. Accounting Release No. 25*, May 29, 1941, and *No. 16*, March 16, 1940; *Associated Gas and Electric Co.*, 6 S. E. C. 605, 619, 620; Paton, *Accountants' Handbook* (Third Ed., 1943), p. 1014. Moreover, in quasi-reorganizations, the plant accounts of utilities are not restated to reflect increased value.[42] The charging-off of the "write-up" in question thus involves none of the aspects of a reorganization or quasi-reorganization.

[42] The reorganization cases, cited by petitioners (Br. p. 51), are not in point insofar as they require consideration to be given to value. The necessity for the ascertainment of value in such cases was stated by this Court in *Consolidated Rock Co.* v. *DuBois*, 312 U. S. 510, 524, to be "so that criteria will be available to determine an appropriate allocation of new securities between bondholders and stockholders in case there is an equity remaining after the bondholders have been made whole." No such considerations conceivably are present in this case.

B. SECTION 318 OF THE FEDERAL POWER ACT DOES NOT INVALIDATE THE COMMISSION'S ORDER

Petitioners contend that Section 318 of the Federal Power Act deprives the Commission of jurisdiction to enter the order here involved (Pet. 10, 21, 30–31; Pet. Br. pp. 37–38, 69). But in exempting from the requirements of the Act any matter as to which a requirement of the Public Utility Holding Company Act of 1935 applies, Section 318 merely resolves in favor of the Securities and Exchange Commission (S. E. C.) any conflicts which may arise between it and the Federal Power Commission. No conflict here exists.

There is no substance to the contention made in the petition (p. 21), but apparently abandoned in petitioners' brief, that there is a conflict between the accounting requirements of the two agencies, for "the regulations of the S. E. C. preclude any possibility of conflict." Moreover, peti-

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"Rule U-26 of the S. E. C. (17 C. F. R. (1941 Supp.) 250.26 (c)) provides in part:

"No company subject to the Uniform System of Accounts shall keep any other or different accounts with respect to any subject matter covered by such Uniform System other than: * * *

"(2) Accounts or records required by applicable State or Federal laws * * *."

Rule U-27 of the S. E. C. (17 C. F. R. (1941 Supp.) 250.27) provides:

"(a) Every registered holding company, and subsidiary thereof, which is a public utility company and which is not required by either the Federal Power Commission or a State commission to conform to a classification of accounts, shall

tioners speak only of a conflict *in futuro* (Pet. 21) not of an existing conflict.[45] It will be time enough to consider such a conflict if and when it arises.

Petitioners' suggestion (Pet. Br. 37–38) that the Commission's order may conflict with the jurisdiction of the S. E. C. under Section 12 (c) of the Public Utility Holding Company Act with respect to the payment of dividends by Northwestern is likewise unfounded. The order of the Commission is not a dividend order; it is an accounting order which has the effect of absorbing earned surplus that might otherwise be available for dividends. This result is indeed a natural consequence of the exercise of the accounting authority to which the rights of stockholders are necessarily

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keep its accounts, insofar as it is an electric utility company, in the manner currently prescribed for similar companies by the Federal Power Commission or, and insofar as it is a gas utility company, in the manner currently recommended by the National Association of Railroad and Utilities Commissioners, except any company whose public utility activities are so limited that the application to it of such system of accounts is clearly inappropriate. A company claiming that its activities are thus limited, shall apply to the Commission for written instructions to that effect."

In announcing a recent amendment, not pertinent here, to this rule, the S. E. C. stated (Holding Company Act Release No. 4691, November 17, 1943): "That Rule prescribes uniform systems or classifications of accounts for utility companies which are not otherwise required under Federal or State law to conform to a classification."

[45] Their petition states (p. 21): "Indeed, the Securities and Exchange Commission, acting under Section 15 of the Public Utility Holding Company Act, *may* exclude the Federal Power Commission from any exercise of jurisdiction over Northwestern's accounts."

subject. *Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423, 441, 445. As clearly indicated in the statement of the S. E. C. (Appendix D, pp. 97–131, *infra*), the Federal Power Commission's order does not conflict with the rules of the S. E. C. under Section 12 (c) of the Holding Company Act.

Nothing in the Commission's orders directs whether or when dividends shall be paid; they leave the way open for payment of dividends if the company desires and is legally able to pay them.[46] Under Section 12 (c) of the Holding Company Act, the S. E. C. is at liberty, notwithstanding the provisions of the Power Commission's order, to prohibit the payment of dividends on the preferred stock until the "write-up" is eliminated. So far from conflicting with the authority of the S. E. C., the order here involved has in fact been coordinated with the requirements of the S. E. C. as to dividends (1 R. 69). Thus, the Power Commission expressly refrained from requiring the application of the company's existing surplus, at the date of the order, to the extinguishment of the "write-up" because the S. E. C. in an opinion and order dated October 19,

[46] Petitioners' contention that the Commission's determination may affect the payment of dividends on the preferred stock as well as the common stock (Pet. Br. 73) is belied by the fact that Northwestern, under the method of disposition prescribed by the Commission, has continued to pay its preferred stock dividends. Moody's *Public Utilities* (1943), p. 1516.

1939 (*Northwestern Electric Company*, 6 S. E. C., 57, 61, 66) had placed restrictions on the payment of dividends on the common stock (and recognized the possibility of even broader limitations under the bond indenture of Northwestern)—a restriction which the Power Commission construed as having "the effect of impounding the Company's earned surplus of $983,160.45 as of that date." (1 R. 68–69).[47] For these reasons, and for those set forth in the statement of the S. E. C. (Appendix D, pp. 97–131, *infra*), we submit that any contention of conflict between the requirements of the two regulatory agencies is pure obfuscation.

IV.

There Is No Constitutional Objection to the Commission's Order

Petitioners contend that the order of the Commission constitutes a taking of their property within the prohibition of the Fifth Amendment,

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[47] Notwithstanding Northwestern's contention (Pet. Br. 69–71) that the order is arbitrary because it does not permit the use of this existing surplus towards the elimination of the "write-up," the fact remains that Northwestern has never come forward with any evidence to show that the Commission misconstrued the provisions of the S. E. C. restriction and that such existing surplus is available for the write-off. This it has been at liberty at all times to do and is still at liberty to do. As a matter of fact, the company is at liberty to petition the Commission for permission to apply all current earnings towards elimination of the "write-up," including preferred stock dividend requirements.

and an invasion of the powers reserved to the states by the Tenth Amendment; and they argue that if the Federal Power Act authorizes such an order, it is to that extent unconstitutional (Pet. Br. 40–60). There is no substance to these assertions.

A. THERE IS NO TAKING OF PETITIONERS' PROPERTY

1. *Northwestern Electric Company*

The Commission's order provides for the elimination of a fictitious asset entry by specified annual charges against earned surplus, the amount of such charges being measured by the excess of annual income over preferred stock dividend requirements. In directing this accounting charge, the order clearly takes no property from Northwestern. Everything it owned it still retains; it has been required to part with nothing. When the prescribed amortization has been completed, the accounts will reflect only the real assets and not fictitious or conjectural assets. But the amounts utilized in disposing of the "write-up" will remain in the business, available for investments in additional electric plant and improvements or for partial retirement of Northwestern's bonded indebtedness, or for any other lawful and proper purpose. There is therefore no substance to any claim of a taking of Northwestern's property.

2. *American Power & Light Company*

The order of the Commission here under attack is not directed to American Power & Light Company [*] nor does it require any action of that company. American's rights in the case at bar are predicated on its ownership of all the common stock of Northwestern. This circumstance, of course, does not make American the owner of any of Northwestern's property; earnings of a corporation do "not become the property of the stockholders, unless and until it is distributed among them by the corporation." *Gibbons* v. *Mahon*, 136 U. S. 549, 558. American's stock ownership merely entitles it to receive such dividends out of earnings as may validly be declared and paid, and, upon dissolution of Northwestern, to receive the property which remains after creditors and senior security holders have been satisfied. Nothing in the Commission's order purports to interfere with or affect American's rights in either of these respects. The fact that the Commission's order may have some repercussions upon American is merely one of the incidents attending ownership of stock in a regulated utility. Many regulatory orders

[*] Petitioners' query (Br. 44) as to why American was permitted to intervene unless to defend its investment is answered by the Commission's order permitting intervention. That order disclosed that American's intervention was granted as a matter of grace (Sec. 308 (a)) and did not involve any concession that the character of the evidence which it proposed to submit was relevant or that it was legally "aggrieved" by the original order (2 F. P. C. 859).

reduce the earnings of the regulated company, but so far as we know such orders have not been held on that account to constitute unlawful takings from, or create an independent cause of action in, the stockholders of the company. Their constitutional rights must be vindicated by the action of the regulated company itself.[49] To the extent that American's interest is purely derivative from Northwestern, the reasons for the conclusion that there has been no taking of Northwestern's property are equally applicable to American.[50] Moreover, even though the order absorbs surplus which might otherwise be available for dividends, American has no cause for complaint, since, as the owner of all the common stock, its ultimate equity increases in value in at least direct proportion to the extent that net earnings are retained by Northwestern (1 R. 21).

Both petitioners urge that under Washington law the stock held by American must be regarded as fully paid up and nonassessable (Pet. Br. 35).

[49] Where stockholders desire to test the constitutionality of a regulatory order, the form ordinarily employed is that of a stockholders' suit against the company seeking to enjoin compliance with the order alleged to be unconstitutional. See *Carter* v. *Carter Coal Co.*, 298 U. S. 238, 286–287; *Ashwander* v. *Valley Authority*, 297 U. S. 288, 318–321.

[50] Because of intervention of stockholders, fictitious items should not be permitted "'to assume the nature of vested interests.' *Clarion River Power Co.* v. *Hurley*, 59 Wash. Law Rep., 106, 108." *Louisville Gas & Electric Co.* v. *Federal Power Commission*, 129 F. (2d) 126, 133 (C. C. A. 6), certiorari denied, 318 U. S. 761.

The order of the Commission, however, does not attempt to determine or affect the status of the stock under Washington law. Its sole effect was to require that an item in the plant account found to be fictitious should be charged against surplus.[11]

Finally, petitioners claim that a judgment of the Superior Court for the State of Washington precludes the Commission's order (Pet. Br. 35). That judgment was rendered in a suit brought by several persons owning only 84 shares of preferred stock (5 R. 992–995), to require the cancellation

[11] The Commission recognized that the disposition of the "write-up" prescribed by its order was "the equivalent of obtaining ultimately from the holders of the common stock (the holding company) a consideration of $3,500,000 for the stock," and observed that "dividends should not be paid on the Common Stock until it has the equivalent of a paid-in value" (1 R. 69). This does not support petitioners' contention that the Commission was seeking, by its order, to collect an unpaid stock subscription from American (Pet. Br. 35), for the Commission was not undertaking to pass upon the question of whether the stock under Washington law had a fully paid and nonassessable status. As stated in its second opinion, the Commission was "concerned solely with the proper disposition of what has heretofore been determined to be a fictitious element in the accounts of the company." (5 R. 1168.) It found that the prescribed disposition would avoid the creation of "a large deficit in the surplus account, with the consequent detriment to the preferred stockholders" and that such disposition was "reasonable and in the public interest" (5 R. 1168, 1169). If the Commission had ordered the entire "write-up" charged off at once to earned surplus, thereby creating a deficit, the effect upon the payment of common stock dividends would have been the same, since the dividend arrearages which would accrue on the preferred stock (which is cumulative) would have to be paid up before any dividend could be declared on the common stock.

of the common stock held by American or, in the alternative, to require American to pay the par value of such stock. A stipulation entered into between the plaintiffs in that action and petitioners provided that in consideration of the payment of a sum of $3,500 to the plaintiffs and their counsel (5 R. 1046) and the reduction of the par value of the common stock from $10,000,000 to $3,500,000, a final decree "upon the merits of this action in the form hereunto annexed shall be entered in this action upon application of any of the parties hereto" (5 R. 1045). Th judgment entered pursuant to the stipulation decreed that American was the owner of 100,000 shares of fully paid and nonassessable common capital stock of Northwestern of the par value of $35 per share

> free and clear of any and all cloud cast upon said stock or the title of said defendant American Power & Light Company thereto by reason of any matter or thing alleged by the plaintiffs herein, and that the title of said defendant American Power & Light Company * * * is now and hereby quieted as against the plaintiffs and all persons claiming or who may hereafter claim by, through or under the plaintiffs, or any of them, and as against all persons or parties whomsoever situated similarly to the plaintiffs herein or in whose behalf this action may be held to have been instituted as

> a representative action by the plaintiffs * * *. (5 R. 1050–51.)

As a consent decree in a stockholder's suit, this could of course be binding only upon the class of stockholders who were plaintiffs in the action.[42] Consequently, it is only against preferred stockholders that American can assert a judicial determination that the common stock is nonassessable and fully paid up. Otherwise it would be a void judgment because lacking the elements of due process. *Pennoyer* v. *Neff*, 95 U. S. 714.

But even if it were entitled to broader effect, the judgment in the Washington suit, being based upon "agreements made by the stockholders amongst themselves" which have the effect of "apportioning profits to one or the other class of stockholders," cannot be permitted to restrain the operation of legitimate regulation by Congress and the Commission. *Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423, 453–454. The following quotation from the opinion of this Court in that case answers, we believe, all questions which the petitioners here raise under the Fifth Amendment (231 U. S. at 453–454):

> But, aside from that, the Interstate Commerce Act deals with the carrier in its ca-

[42] Neither the Oregon Commissioner nor the Washington Public Service Department was a party to the stockholders' litigation, which "was a private suit between the parties" (5 R. 1053).

pacity as a servant of the public, and as a distinct entity, amenable to the legitimate regulation of Congress and the Commission. If in this aspect the carrier is not unwarrantably injured or deprived of its property by the exercise of the regulatory powers, the operation of such regulations cannot be restrained on the ground of agreements made by the stockholders amongst themselves for apportioning profits to one or the other class of stockholders. To admit this might materially hamper the Federal control over interstate carriers, and evidently would tend to render impracticable the standardization of methods of accounting.

B. THERE IS NO VIOLATION OF THE TENTH AMENDMENT

Petitioners contend that the Commission's order is unauthorized because it relates to a field in which power has been reserved to the States by the Tenth Amendment (Pet. Br. 40). This is tantamount to a contention that the Tenth Amendment to the Constitution supersedes the commerce clause. *United States* v. *Darby*, 312 U. S. 100, 123–124. This argument has been repeatedly discredited by the numerous decisions of this Court holding that the powers of the Federal Government under the commerce clause are complete and even extend to all matters which may affect interstate commerce. *E. g.*, *Warren-Brad-*

shaw Drilling Co. v. *Hall*, 317 U. S. 88; *Wickard* v. *Filburn*, 317 U. S. 111, 128–129. Federal regulation of the interstate transmission of electricity may of course properly be made complete. Cf. *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U. S. 61.

Petitioners seek to support their argument by contending that the reduction of the capital stock from a par value of $10,000,000 to $3,500,000 was regularly submitted to and approved by the Oregon Commissioner and the Washington Public Service Department, and petitioners apparently contend that under such orders the capital stock was determined to be fully paid up and nonassessable (Pet. Br. 7). The orders to which petitioners refer themselves belie this contention, making it plain that the transaction was viewed as a purely voluntary one *inter partes*, without any binding effect upon regulatory powers. Thus the order of the Department of Public Service of Washington provided (2 R. 585–586):

> It is ordered, that said application be and the same hereby is granted, that the proposed reduction of the par value of applicant's authorized and outstanding 100,000 shares of common stock from $100.00 per share to $35.00 per share is approved without prejudice to any future action with respect thereto which the Department is now

or may be hereafter authorized by law to take; and that applicant is authorized and empowered to issue certificates evidencing 100,000 shares of its fully paid and non-assessable common stock of said par value of $35.00 per share in exchange for and upon the surrender and cancellation of the certificates now outstanding;

Provided, however, that neither this authorization or approval nor anything done pursuant thereto shall ever be construed in anywise as a determination by the Department as to the value of said common stock, or as to a finding by the Department of cost or value of assets of applicant, or have any bearing or relevancy thereon. And that the approval of the Department herein to the issuance of 100,000 shares of fully paid non-assessable common stock of a par value of $35.00 per share, in exchange for and the surrender and cancellation of the 100,000 shares of common stock of a par value of $100.00 per share presently outstanding, shall never be construed in anywise other than its consent to a voluntary reduction by applicant of the stated value of its common stock.

And, further, that this intercorporate transaction between affiliated companies shall not in any manner be construed as estopping or precluding the Department from taking further action as it may deter-

mine proper at such time or times as may be deemed appropriate in order to enable it to carry out the duties imposed by law.

The order of the Commissioner of Public Utilities of Oregon was similarly qualified (2 R. 575–580). Clearly, the Oregon and Washington agencies did no more than authorize a voluntary write-down of capital stock on the ground that it was a step in the right direction; they specifically reserved the question as to whether further steps should be taken. That the Power Commission's order in the instant case does not interfere in any way with those of the state agencies is apparent from comparison of the orders, and is confirmed by the appearance of both state agencies as *amici curiae* in the court below, urging affirmance of the Commission's order.

In any event the stockholders' suit and its settlement could under no legal principle prevent the Commission from exercising its statutory function in regulating the plant accounts of Northwestern. The Commission's order does not go to the capital stock account, much less to the stock itself. The Commission has addressed itself solely to the removal of inflation from the plant accounts, a sound public utility accounting procedure; and what follows is merely one of the incidents noted by this Court in *Kansas City So. Ry. Co.* v. *United States*, 231 U. S. 423, 454.

CONCLUSION

For the reasons stated, it is respectfully submitted that the judgment below should be affirmed.

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DECEMBER 1943.

APPENDIX A

STATUTES

The Federal Power Act of 1935, 49 Stat. 847–863 (16 U. S. C. 824, 825), provides in part:

> SECTION 201. (a) It is hereby declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this Part and the Part next following and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.
>
> SEC. 203. (a) No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, or any part thereof of a value in excess of $50,000, or by any means whatsoever, directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person, or purchase, acquire, or take any security of any other public utility, without first having secured an order of the Commission authorizing it to do so. Upon application for such approval the Commission shall give reasonable notice in writing to the Governor and State commission of each of the

States in which the physical property affected, or any part thereof, is situated, and to such other persons as it may deem advisable. After notice and opportunity for hearing, if the Commission finds that the proposed disposition, consolidation, acquisition, or control will be consistent with the public interest, it shall approve the same.

SEC. 205. (a) All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

* * * * *

(d) Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is

filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such

amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

SEC. 206. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

(b) The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

SEC. 208. (a) The Commission may investigate and ascertain the actual legiti-

mate cost of the property of every public utility, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation, and the fair value of such property.

(b) Every public utility upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction.

SEC. 301. (a) Every licensee and public utility shall make, keep, and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this Act, including accounts, records, and memoranda of the generation, transmission, distribution, delivery, or sale of electric energy, the furnishing of services or facilities in connection therewith, and receipts and expenditures with respect to any of the foregoing: *Provided, however,* That nothing in this Act shall relieve any public utility from keeping any accounts, memoranda, or records which such public utility may be required to keep by or under authority of the laws of any State. The Commission may prescribe a system of accounts to be kept by licensees and public utilities and may classify such licensees and public utilities and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts

in which particular outlays and receipts shall be entered, charged, or credited. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry, and the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof.

SEC. 302. (a) The Commission may, after hearing, require licensees and public utilities to carry a proper and adequate depreciation account in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may, from time to time, ascertain and determine, and by order fix, the proper and adequate rates of depreciation of the several classes of property of each licensee and public utility. Each licensee and public utility shall conform its depreciation accounts to the rates so ascertained, determined, and fixed. The licensees and public utilities subject to the jurisdiction of the Commission shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such licensee or public utility shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any public

utility, the percentage rate of depreciation to be allowed, as to any class of property of such public utility, or the composite depreciation rate, for the purpose of determining rates or charges.

SEC. 304. (a) Every licensee and every public utility shall file with the Commission such annual and other periodic or special reports as the Commission may by rules and regulations or order prescribe as necessary or appropriate to assist the Commission in the proper administration of this Act. The Commission may prescribe the manner and form in which such reports shall be made, and require from such persons specific answers to all questions upon which the Commission may need information. The Commission may require that such reports shall include, among other things, full information as to assets and liabilities, capitalization, net investment, and reduction thereof, gross receipts, interest due and paid, depreciation, and other reserves, cost of project and other facilities, cost of maintenance and operation of the project and other facilities, cost of renewals and replacement of the project works and other facilities, depreciation, generation, transmission, distribution, delivery, use, and sale of electric energy. The Commission may require any such person to make adequate provision for currently determining such costs and other facts. Such reports shall be made under oath unless the Commission otherwise specifies.

SEC. 305. (a) It shall be unlawful for any officer or director of any public utility to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation,

or sale by such public utility of any security issued or to be issued by such public utility, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of such public utility from any funds properly included in capital account.

SEC. 307. (a) The Commission may investigate any facts, conditions, practices, or matters which it may find necessary or proper in order to determine whether any person has violated or is about to violate any provision of this Act or any rule, regulation, or order thereunder, or to aid in the enforcement of the provisions of this Act or in prescribing rules or regulations thereunder, or in obtaining information to serve as a basis for recommending further legislation concerning the matters to which this Act relates. The Commission may permit any person to file with it a statement in writing under oath or otherwise, as it shall determine, as to any or all facts and circumstances concerning a matter which may be the subject of investigation. The Commission, in its discretion, may publish or make available to State commissions information concerning any such subject.

SEC. 309. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this Act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this Act; and may prescribe the form or forms of al lstatements, declarations, applications, and reports to be filed with the Commission, the information which

they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

SEC. 311. In order to secure information necessary or appropriate as a basis for recommending legislation, the Commission is authorized and directed to conduct investigations regarding the generation, transmission, distribution, and sale of electric energy, however produced, throughout the United States and its possessions, whether or not otherwise subject to the jurisdiction of the Commission, including the generation, transmission, distribution, and sale of electric energy by any agency, authority, or instrumentality of the United States, or of any State or municipality or other political subdivision of a State. It shall, so far as practicable, secure and keep current information regarding the ownership, operation, management, and control of all facilities for such generation, transmission, distribution, and sale; the capacity and output thereof and the relationship between the two; the

cost of generation, transmission, and distribution; the rates, charges, and contracts in respect of the sale of electric energy and its service to residential, rural, commercial, and industrial consumers and other purchasers by private and public agencies; and the relation of any or all such facts to the development of navigation, industry, commerce, and the national defense. The Commission shall report to Congress the results of investigations made under authority of this section.

SEC. 313. (b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the Circuit Court of Appeals of the United States for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is

reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

(c) The filing of an application for rehearing under subsection (a) shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

SEC. 314. (a) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this Act, or of any rule, regulation, or order thereunder, it may in its discretion bring an action in the proper District Court of the United States, the Supreme Court of the District of Columbia, or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this Act or any rule, regulation, or order thereunder, and upon a proper showing a permanent or temporary injunction or decree or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who, in his discretion, may institute the necessary criminal proceedings under this Act.

SEC. 316. (a) Any person who willfully and knowingly does or causes or suffers to be done any act, matter, or thing in this Act prohibited or declared to be unlawful, or who willfully and knowingly omits or fails to do any act, matter, or thing in this Act required to be done, or willfully and knowingly causes or suffers such omission or failure, shall, upon conviction thereof, be punished by a fine of not more than $5,000 or by imprisonment for not more than two years, or both.

(b) Any person who willfully and knowingly violates any rule, regulation, restriction, condition, or order made or imposed by the Commission under authority of this Act, or any rule or regulation imposed by

the Secretary of War under authority of Part I of this Act shall, in addition to any other penalties provided by law, be punished upon conviction thereof by a fine of not exceeding $500 for each and every day during which such offense occurs.

SEC. 318. If, with respect to the issue, sale, or guaranty of a security, or assumption of obligation or liability in respect of a security, the method of keeping accounts, the filing of reports, or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 or of a rule, regulation, or order thereunder and to a requirement of this Act or of a rule, regulation, or order thereunder, the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this Act, or of any rule, regulation, or order thereunder, with respect to the same subject matter, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this Act shall apply to such person.

ASSETS AND OTHER DEBITS

Utility Plant

100. Electric Plant.
107. Electric Plant Adjustments.
108. Other Utility Plant.

Investment and Fund Accounts

110. Other Physical Property.
111. Investments in Associated Companies.
112. Other Investments.
113. Sinking Funds.
114. Miscellaneous Special Funds.

Current and Accrued Assets

120. Cash.
121. Special Deposits.
122. Working Funds.
123. Temporary Cash Investments.
124. Notes Receivable.
125. Accounts Receivable.
126. Receivables from Associated Companies.
127. Subscriptions to Capital Stock.
128. Interest and Dividends Receivable.
129. Rents Receivable.
130. Accrued Utility Revenues.
131. Materials and Supplies.
132. Prepayments.
133. Other Current and Accrued Assets.

PENDIX B

ANCE SHEET

LIABILITIES AND OTHER CREDITS

Capital Stock

200. Common Capital Stock.
201. Preferred Capital Stock.
202. Stock Liability for Conversion.
203. Premiums and Assessments on Capital Stock.
204. Capital Stock Subscribed.
205. Installments Received on Capital Stock.

Long-Term Debt

210. Bonds.
211. Receivers' Certificates.
212. Advances from Associated Companies.
213. Miscellaneous Long-Term Debt.

Current and Accrued Liabilities

220. Notes Payable.
221. Notes Receivable Discounted.
222. Accounts Payable.
223. Payables to Associated Companies.
224. Dividends Declared.
225. Matured Long-Term Debt.
226. Matured Interest.
227. Customers' Deposits.
228. Taxes Accrued.
229. Interest Accrued.
230. Other Current and Accrued Liabilities.

Deferred Credits

240. Unamortized Premium on Debt.
241. Customers' Advances for Construction.
242. Other Deferred Credits.

120. Cash.
121. Special Deposits.
122. Working Funds.
123. Temporary Cash Investments.
124. Notes Receivable.
125. Accounts Receivable.
126. Receivables from Associated Companies.
127. Subscriptions to Capital Stock.
128. Interest and Dividends Receivable.
129. Rents Receivable.
130. Accrued Utility Revenues.
131. Materials and Supplies.
132. Prepayments.
133. Other Current and Accrued Assets.

Deferred Debits

140. Unamortized Debt Discount and Expense.
141. Extraordinary Property Losses.
142. Preliminary Survey and Investigati
Charges.
143. Clearing Accounts.
144. Retirement Work in Progress.
145. Other Work in Progress.
146. Other Deferred Debits.

Capital Stock Discount and Expense

150. Discount on Capital Stock.
151. Capital Stock Expense.

Reacquired Securities

152. Reacquired Capital Stock.
153. Reacquired Long-Term Debt.

220. Notes Payable.
221. Notes Receivable Discounted.
222. Accounts Payable.
223. Payables to Associated Companies.
224. Dividends Declared.
225. Matured Long-Term Debt.
226. Matured Interest.
227. Customers' Deposits.
228. Taxes Accrued.
229. Interest Accrued.
230. Other Current and Accrued Liabilities.

Deferred Credits

240. Unamortized Premium on Debt.
241. Customers' Advances for Construction.
242. Other Deferred Credits.

Reserves

250. Reserve for Depreciation of Electric Plant.
251. Reserve for Amortization of Limited-Term Electric Investments.
252. Reserve for Amortization of Electric Plant Acquisition Adjustments.
253. Reserve for Depreciation and Amortization of Other Property.
254. Reserve for Uncollectible Accounts.
255. Insurance Reserve.
256. Injuries and Damages Reserve.
257. Employees' Provident Reserve.
258. Other Reserves.

Contributions in Aid of Construction

265. Contributions in Aid of Construction.

Surplus

270. Capital Surplus.
271. Earned Surplus.

APPENDIX C

Excerpts From Systems of Account Prescribed by Regulatory Authorities Prior to and Since 1937 Requiring Plant To Be Recorded at Cost

General instructions regarding the form prescribed by the Board of Gas Commissioners of Massachusetts for the books and accounts to be kept by electric light companies (1887), p. 1:

COST OF WORKS

> This account should show, either in detail or in one "Construction Account," the cost of the Company's works, including real estate, steam plant, electric plant, meters, lines, lamps and globes, as they stood on its books on the 30th day of June, 1887. Important additions to works and extensions of lines should be charged to this account.

Uniform system of accounts for electrical corporations prescribed by State of New York Public Service Commission, Second District (1908), p. 7:

> 17. *Costs of new capital to be actual money costs.*—All charges made to capital or other accounts on or after January 1, 1909, shall be the actual money cost of the things in respect of which they are made. When the consideration actually given for the thing in respect of which a charge to a capital account is made is anything other than money, the actual consideration shall be described in the entry with sufficient fullness and particularity to identify it, and the

amount charged shall be the actual money value of such consideration at the time of the transaction.

Uniform classification of accounts for electric utilities, gas utilities, and water utilities prescribed by Railroad Commission of Oregon, effective July 1, 1913 (2 R. 628, 631):

> 11. *Cost To Be Actual Money Costs.*—All charges made to fixed capital or other property accounts with respect to any property acquired on or after July 1, 1913, should be the actual money cost of the property. When the consideration actually given for anything with respect to which a charge is made to any fixed capital or other property account is anything other than money, the actual consideration should be described in the entry with sufficient fullness and particularity to identify it, and the account charged should be actual money value of such consideration at the time of the transaction.

Classification of investment in road and equipment of steam roads prescribed by the Interstate Commerce Commission effective July 1, 1914, p. 11:

> *Costs* shall be actual money costs to the carrier * * *
>
> 3. *Basis of Charges.*—The charges to the accounts of this classification shall be based upon the cost of the property acquired. When the consideration given for the purchase or the improvement of property the cost of which is chargeable to the accounts of this classification is other than money, the money value of the consideration at the time of the transaction shall be charged to these accounts, and the actual consideration shall

be described in the record in sufficient detail to identify it. The carrier shall be prepared to furnish the Commission, upon demand, the particulars of its determination of the actual cash value of the consideration, if other than money.

4. *Cost of Construction.*—It is intended that the accounts for fixed improvements and equipment shall include the cost of construction of such property. The cost of construction shall include the cost of labor, materials and supplies, work-train service, special machine service, transportation, contract work, protection from casualties, injuries and damages, privileges, and other analogous elements in connection with such work. * * *

Uniform classification of accounts for electrical utilities prepared by National Association of Railway and Utilities Commissioners (1922), pp. 30–31:

3. *Fixed Capital To Be Entered and Retained on Books at Cost.*—

All charges to fixed-capital accounts shall be at the actual cost of the property acquired, at the time of its acquisition. A *bona fide* contract or agreement of purchase and sale between entirely separate parties shall be *prima facie* evidence of actual cost. Each item of property shall be carried in the fixed-capital accounts at no more, and no less, than its actual cost unless, or until, such property is abandoned, replaced, reconstructed, or converted, when the accounting shall be as hereinafter set forth. The foregoing shall not, however, be interpreted to forbid the inclusion in account No. 357 "Fixed Capital Not Classified by Prescribed Accounts" of undis-

tributed book values which have been carried prior to the effective date of prescribed uniform system of accounts, and which may or may not represent the actual cost of property in service; but the inclusion of such undistributed book values in fixed-capital accounts shall be without prejudice to any future determination of the actual cost of the property. The term "cost" includes not only the cost of labor, material, and supplies directly employed or consumed in the construction and installation of fixed capital, but also the cost of preliminary plans and surveys and such portion of the expenses for engineering and plant supervision and of general expenses as may be chargeable to the fixed-capital accounts under an equitable plan for apportionment of such expenses.

NOTE.—This paragraph was included in classifications adopted by numerous State regulatory bodies, including, among others, the following: Illinois Commerce Commission for Gas Utilities (1923), p. 30; Public Service Commission of West Virginia for Electrical Utilities (1923), p. 43; Railroad Commission of Wisconsin for Classes A and B Electric Utilities (1923), pp. 28–29; Public Service Commission of New York for Electrical Corporations (1923), pp. 30–31; Public Service Commission of Indiana for Electric Utilities (1924), pp. 30–31; Public Service Commission of Oregon for Electrical Utilities (1925), pp. 34–35; Public Service Commission of West Virginia for Natural Gas Utilities (1931), p. 34; Public Service Commission of Missouri for Electrical Utilities (1932), p. 41.

Uniform classification of accounts for electrical utilities as prescribed by the Public Service Commission of Oregon, effective January 1, 1925 (3 R. Ex. 19) pp. 34–35.

SEC. 3. *Fixed Capital To Be Entered and Retained on Books at Cost.*—All charges

to fixed capital accounts shall be at the actual cost of the property acquired, at the time of its acquisition. A *bona fide* contract or agreement of purchase and sale between entirely separate parties shall be *prima facie* evidence of actual cost. Each item of property shall be carried in the fixed capital accounts at no more, and no less, than its actual cost unless, or until, such property is abandoned, replaced, reconstructed, or converted, when the accounting shall be as hereinafter set forth. The foregoing shall not, however, be interpreted to forbid the inclusion in account No. 357, "Fixed capital not classified by prescribed accounts," of undistributed book values which have been carried prior to the effective date of a prescribed uniform system of accounts, and which may or may not represent the actual cost of property in service; but the inclusion of such undistributed book values in fixed capital accounts shall be without prejudice to any future determination of the actual cost of the property. The term "cost" includes not only the cost of labor, material, and supplies directly employed or consumed in the construction and installation of fixed capital, but also the cost of preliminary plans and surveys and such portion of the expenses for engineering and plant supervision and of general expenses as may be chargeable to the fixed capital accounts under an equitable plan for apportionment of such expenses.

Uniform system of accounts prescribed by the Federal Communications Commission for class A and B telephone companies (47 C. F. R. 271, 272):

(j) "Cost," except as applied to telephone plant, franchises, patent rights, and right-of-way, means the amount of money actually paid (or the current money value of any consideration other than money exchanged) for property or services. (Note also paragraph (x) of this section.)

(x) "Original cost" or "Cost," as applied to telephone plant, franchises, patent rights, and right-of-way, means the actual money cost of (or the current money value of any consideration other than money exchanged for) property at the time when it was first dedicated to the public use, whether by the accounting company or by predecessors.

Uniform system of accounts prescribed for class A, B, and C electric utilities by Public Utilities Commissioner of Oregon, effective January 1, 1937 (3 R. Ex. 61), pp. 55–56:

3. *Utility Plant To Be Recorded at Cost.*—

A. All amounts included in the accounts for tangible utility plant consisting of plant acquired as an operating unit or system shall be stated at the original cost incurred by the person who first devoted the property to utility service. All other tangible utility plant shall be included in the accounts at the cost incurred by the utility.

B. All amounts included in the accounts for intangible utility plant shall likewise be stated on the basis provided in paragraph A above except as otherwise provided in the texts of the intangible accounts.

C. Where the term "cost" is used in the detailed utility plant accounts, it shall have the meaning stated in paragraphs A and B above and shall include not only the mate-

rials, supplies, labor, services and other items consumed or employed in the construction and installation of utility plant, but also the cost of preliminary studies, plans, surveys, engineering, supervision, and general expenses, which contribute directly and immediately to utility plant without duplication of such costs.

D. When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis. In the entry recording such transaction, the actual consideration shall be described with sufficient particularity to identify it. The utility shall be prepared to furnish the Commission the particulars of its determination of the cash value of the consideration, if other than cash.

Uniform system of accounts prescribed by the Department of Public Service of Washington for electric utilities, effective January 1, 1938 (3 R. Ex. 29), p. 47:

3. *Utility Plant to be Recorded at Cost.*—

A. All amounts included in the accounts for tangible utility plant consisting of plant acquired as an operating unit or system shall be stated at the original cost incurred by the person who first devoted the property to utility service. All other tangible utility plant shall be included in the accounts at the cost incurred by the utility.

B. All amounts included in the accounts for intangible utility plant shall likewise be stated on the basis provided in paragraph A above except as otherwise provided in the texts of the intangible accounts.

C. Where the term "cost" is used in the detailed utility plant accounts, it shall have the meaning stated in paragraphs A and B

above and shall include not only the materials, supplies, labor services and other items consumed or employed in the construction and installation of utility plant, but also the cost of preliminary studies, plans, surveys, engineering, supervision, and general expenses, which contribute directly and immediately to utility plant without duplication of such costs.

D. When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis. In the entry recording such transaction, the actual consideration shall be described with sufficient particularity to identify it. The utility shall be prepared to furnish the Commission the particulars of its determination of the cash value of the consideration, if other than cash.

APPENDIX D

SECURITIES AND EXCHANGE COMMISSION
PHILADELPHIA

OFFICE OF THE CHAIRMAN,
December 10, 1943.

The HONORABLE THE SOLICITOR GENERAL,
Department of Justice,
Washington, D. C.

Re: *Northwestern Electric Co., et al.* v. *Federal Power Commission,* No. 195.

SIR: This will refer to the informal request of the Department of Justice for the views of this Commission regarding certain questions raised in the above named case, and in particular for a statement by this Commission with reference to its practice in connection with the accounts of companies subject both to its jurisdiction and to that of the Federal Power Commission, and with reference to the conflicts of jurisdiction which the Petitioners contend exist between the two Commissions.

The argument concerning asserted conflicts of jurisdiction derives from the circumstance that the Petitioner Northwestern Electric Co. is subject to the jurisdiction of the S. E. C. as a subsidiary of a registered holding company, and is subject to the jurisdiction of the F. P. C. as a utility transmitting electric energy in interstate commerce. Petitioners argue that, under Sec. 318 of the Public Utility Act of 1935 the jurisdic-

tion of the S. E. C. is paramount in case of conflict, and that the order of the F. P. C. under review conflicts with the jurisdiction of the S. E. C.

It is our view that the asserted conflict does not exist in this case. Our reasons are set forth below, together with a statement of our practice on questions concerning the accounts of companies which are subject to our jurisdiction as well as to that of the F. P. C. (For your convenience in following the discussion below, we have appended to this letter the statutes and the rules and opinions of the S. E. C. which are cited in this letter.)

Section 318 of the Public Utility Act of 1935 resolves the question of possible conflicting requirements of the Public Utility Holding Company Act of 1935 and rules, regulations, and orders thereunder with the Federal Power Act and rules, regulations and orders thereunder by providing that in case of conflict the requirements of the former Act shall prevail. Not all of the provisions of the Public Utility Holding Company Act of 1935 are self-operative, however; and in the absence of rules, regulations or orders of the S. E. C. implementing such provisions of that Act, these provisions neither compel nor prohibit any action. Until the S. E. C. does by rule or order impose "requirements" pursuant to the sections which are not self-operative, there can be no conflict of requirements and Sec. 318 does not apply. It was not intended that utility companies should be able to thwart regulation by the F. P. C. by conjuring up under Sec. 318

imaginary conflicts with *potential* action of the S. E. C.

In the present case, all of the argument of the Petitioners as to alleged conflict between the jurisdictions of the F. P. C. and S. E. C. relates to sections of the Public Utility Holding Company Act of 1935 which are not self-operative. The sections to which the argument might be applicable are 15 (a), 20, 12 (c) and 11 (b). In our view no action taken by the S. E. C. applicable to Petitioner Northwestern conflicts with the action of the F. P. C. in the case under review.

1. (a) The S. E. C. has power over accounts of companies subject to its jurisdiction, pursuant to Secs. 15 (a) and 20. But it has not prescribed a system of accounts applicable to all operating utility companies subject to its jurisdiction. On the contrary, its rule prescribing a uniform system of accounts operates only where the F. P. C. or a state commission does not exercise accounting control. S. E. C. Rule U-27 provides in part:

> Rule U-27. Classification of Accounts prescribed for Utility Companies Not Already Subject Thereto.
>
> Every registered holding company, and subsidiary thereof, which is a public-utility company and which is not required by either the Federal Power Commission or a State commission to conform to a classification of accounts, shall keep its accounts insofar as it is an electric utility company in the manner currently prescribed for similar companies by the Federal Power Commission and insofar as it is a gas utility company in the manner recommended by the National Association of Railroad and Utilities Com-

missioners,[1] except any company whose public utility activities are so limited that the application to it of such system of accounts is clearly inappropriate. A company claiming that its activities are thus limited, shall apply to the Commission for written instructions to that effect.

It is worth noting that even when it has exercised plenary accounting control, the S. E. C. has not formulated a different uniform system of accounts, but has adopted the system of the F. P. C. as its own.

(b) In connection with a debt refunding of Northwestern in 1939, the S. E. C. had occasion to consider Northwestern's financial condition, *Northwestern Electric Co.*, 6 S. E. C. 57 (1939). In that connection the S. E. C.'s authorization of the sale of the new securities was conditioned on a provision that Northwestern's existing surplus should be unavailable for common stock dividends. The F. P. C. has sought to avoid all question with respect to interference with the S. E. C. order by leaving intact the surplus mentioned in the S. E. C. order, and confining the effect of its own order to subsequently created surplus. Northwestern has not sought by application either to F. P. C. or to S. E. C. to have the surplus item in question applied for purposes of the F. P. C. order.[2]

[1] The N. A. R. U. C. uniform system of accounts for gas companies is substantially identical to that adopted by the F. P. C. under the Natural Gas Act.

[2] We cannot now express an opinion as to whether the order of the F. P. C. might be deemed a sufficient financial protection to warrant removal by the S. E. C. of the requirement imposed in its 1939 opinion and order. That question could be decided only after a hearing in which the S. E. C.

(c) The S. E. C. noted in its 1939 opinion that an accounting question was pending before the F. P. C. with respect to the $3,500,000 item. It made no order with respect thereto, leaving the matter for future F. P. C. disposition. Thus the disposition involved in this case is clearly not inconsistent with any accounting jurisdiction exercised by the S. E. C.

While the S. E. C. has exercised no accounting jurisdiction with respect to Northwestern, it does sometimes deal with accounting questions in connection with companies which are also subject to F. P. C. jurisdiction. As part of its regulatory activity over security issues and property trans-

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considered among other things whether the relaxation of its requirement would defeat the expectation of holders of the refunding bonds that their security had a cushion consisting *both* of a sound common stock investment in the amount then claimed by the company *and* the surplus existing August 30, 1939. That question might depend on an interpretation of a provision in the bond indenture, which is only partially summarized in the S. E. C.'s opinion, 6 S. E. C. 57, at 59, as follows:

"The mortgage also provides that so long as any of the bonds now proposed to be issued are outstanding, the applicant will not pay any dividend upon its common or preferred stocks (excepting dividends payable in its common stock), or make any disbursement for the purchase of its stock or make any distribution in liquidation of any of its stock if its surplus is thereby reduced below the amount as of August 31, 1939, less dividend arrears as of that date, and after certain adjustments."

There would be the further question whether preferred stockholders, as well as bondholders, might not need the protection of a limited amount of earned surplus restricted against the payment of common dividend.

actions (Secs. 6 and 7, 9 and 10, and 12), the S. E. C. must consider accounting questions incident to its determination of the financial soundness of the proposed transactions and the truthfulness of financial representations to investors.

In our view this exercise of accounting jurisdiction is not inconsistent with subsequent or concurrent accounting regulation of the same company by the F. P. C., and does not *per se* make Sec. 318 applicable. The S. E. C.'s consideration of accounting problems must frequently occur without the benefit of an original cost study of the type required by Electric Plant Instruction No. 2–D of the F. P. C. Uniform System of Accounts. When such a study is made, further accounting regulation by the F. P. C. may well be appropriate in the light of the facts disclosed.

This dual accounting regulation, in cases where it occurs, has sound pragmatic justification, and is not inconsistent with the purpose of Sec. 318. The S. E. C. cannot withhold the authorization of financial transactions until the completion of original cost studies. In the relation between regulation of accounts and the administration of the financial controls applied by the S. E. C. there is a time factor of considerable importance, both to the companies subject to regulation and to the public interest. The completion of accounting studies and the resolution of controversies with respect to them, including judicial review of administrative findings, is necessarily a time-consuming process. Yet, as the companies subject to regulation so frequently urge upon the S. E. C., time is of the essence in dealing with financial

transactions.[3] In that connection, they emphasize that interest savings will result from refundings of outstanding obligations at current low interest rates, and that failure to meet a particular call date on the outstanding issue may result in a six months' delay or duplicate interest charges. There are also the risks of changing market conditions due to war events or rumors.

In summary, the accounting jurisdiction of the S. E. C. over Northwestern under the Public Utility Holding Company Act of 1935 is pursuant to sections of the statute which are not self-operative, and no orders or rules of the S. E. C. thereunder with respect to Northwestern conflict with the order of the F. P. C. herein.

2. Petitioners argue that the order under review invades the jurisdiction of the S. E. C. under Section 12 (c) of the Public Utility Holding Company Act of 1935. By Section 12 (c), registered holding companies and their subsidiaries are forbidden (among other things) to pay dividends in contravention of such rules and regulations or orders as the S. E. C. deems necessary or appropriate to protect the financial integrity of companies in holding-company systems, to safeguard the working capital of public-utility companies, or to prevent the payment of dividends out of capital or unearned surplus. This section is obviously

[3] The magnitude of the transactions which might have been affected by a time lag incident to complete accounting examination may be seen from the following figures: From December 1, 1935, to June 30, 1943, the total volume of security issues which were authorized under Section 6 and 7 of the Holding Company Act was $5,196,066,000, and there were 805 separate issues of securities.

not self-operative. The only pertinent regulation of the S. E. C. is Rule U–46 (a). That rule forbids dividends out of capital or unearned surplus unless specifically approved by the S. E. C. In considering whether the F. P. C. order invades the province of the S. E. C. under Section 12 (c), perhaps it is unnecessary to do more than repeat that Section 12 (c) is not self-operative, and that the S. E. C. has taken no action thereunder by rule or order which is inconsistent with the F. P. C.'s order in this case. It should be time enough to consider conflicts when they arise.

Speaking more broadly, the enforcement of accounting principles cannot, we believe, interfere with the powers of the S. E. C. under Section 12 (c). Sound accounting practice is a factual prerequisite of regulation designed to protect financial integrity and to prevent payment of dividends out of capital or unearned surplus.

The limited scope of the rule-making power thus far exercised under Section 12 (c) leaves the S. E. C. free in appropriate cases to impose restrictions by order, where necessary to "protect the financial integrity" of companies in holding company systems—and also in exceptional circumstances to permit the payment of dividends out of capital surplus. Absent exceptional circumstances, maintenance of financial integrity precludes payment of dividends other than out of genuine earned surplus. Accordingly, an accounting requirement of the F. P. C. requiring correction of a company's earned surplus account is fully consistent with the jurisdiction of the S. E. C. under Section 12 (c), and does not preclude the S. E. C. from authorizing the payment

of dividends on application, even though no genuine earned surplus exists; or from limiting dividends even when earned surplus exists, if protection of financial integrity so requires. We believe, therefore, that the order does not invade the province of the S. E. C. under Section 12 (c).

3. Petitioners intimate that the order of the F. P. C. effects a quasi-reorganization of Northwestern which would come within the jurisdiction of the S. E. C. under Section 11 (b). This argument is fallacious even assuming that the F. P. C. order has the effect stated by Petitioners. Section 11 (b) is not self-operative, and there is no proceeding pending thereunder which raises any question as to the propriety of requiring a recapitalization of Northwestern. Assuming, however, that the S. E. C. would be warranted in entertaining a plan for such action if filed under Section 11 (e) or requiring such action under Section 11 (b), there is nothing in the order of the F. P. C. which would preclude the S. E. C. from entering such an order as might meet the applicable standards of Section 11 (e): "fair and equitable and necessary to effectuate the provisions of" Section 11 (b). On the contrary, a definitive ruling as to the necessity of eliminating the $3,500,000 item from the accounts of Petitioners, will serve to narrow the issues and facilitate determination of the necessary action under Section 11 (b).[4]

[4] An illustration is furnished by the action taken by Carolina Power & Light Company, as set forth in S. E. C. Holding Company Act Release No. 3995, dated December 19, 1942. Carolina obtained S. E. C. approval for a program which,

4. In their contentions that the F. P. C. order invades the province of the S. E. C., Petitioners have dealt only with the impact of the order on the right hand side (the liability and net worth side) of Northwestern's balance sheet. No asserted conflict with the jurisdiction of the S. E. C. is involved in Petitioners' arguments against that portion of the F. P. C. order which requires the "write-up" to be removed from the left-hand side—the plant accounts. On this point we desire to say merely that we join wholeheartedly in the arguments in the F. P. C. brief that write-ups should be removed from the plant accounts. We believe that an out-and-out write-up such as was involved in this case cannot be eliminated otherwise than by a charge to the proprietorship (or net worth) accounts. We further believe that the elimination of "write-ups" from the plant accounts and the concomitant elimination of inflation from the capital stock and surplus accounts are among the most vital aspects of public utility regulation. In addition to the significance of such elimination from the standpoint of rate regulation, it is a prerequisite to sound financial regulation in the interest of consumers and in-

among other things, involved the elimination from plant account, by charges to earned surplus, of $18,648,438 reclassified to Account 107 by the F. P. C. The resulting deficit was eliminated by charges to capital surplus created in the transaction. (This program was submitted to the S. E. C. under a number of regulatory provisions of the Holding Company Act other than Section 11 (e), but was in effect a partial program for compliance with Section 11 (b).)

vestors. On this basic issue of the case, we are in full agreement with the F. P. C.

Very truly yours.

[Signed] GANSON PURCELL,
Chairman.

ENCLOSURES IN LETTER FROM CHAIRMAN OF SECURITIES AND EXCHANGE COMMISSION

Pertinent provisions of the Public Utility Holding Company Act of 1935 (49 Stat. 803, 15 U. S. C. § 79a *et seq.*) are as follows:

Section 1—

* * * * * *

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such

securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested

* * * * *

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

Section 6—

(a) Except in accordance with a declaration effective under section 7 and with the order under such section permitting such declaration to become effective, it shall be unlawful for any registered holding company or subsidiary company thereof, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, directly or indirectly (1) to issue or sell any security of such company; or (2) to exercise any privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security of such company.

(b) * * * The Commission by rules and regulations or order, subject to such terms and conditions as it deems appropriate in the public interest or for the protection of investors or consumers, shall exempt from the provisions of subsection (a) the issue or sale of any security by any subsidiary company of a registered holding company, if the issue and sale of such security are solely for the purpose of financing the business of such subsidiary company and have been expressly authorized by the

State commission of the State in which such subsidiary company is organized and doing business, * * *

* * * * *

Section 7—

* * * * *

(d) If the requirements of subsections (c) and (g) are satisfied, the Commission shall permit a declaration regarding the issue or sale of a security to become effective unless the Commission finds that—

(1) the security is not reasonably adapted to the security structure of the declarant and other companies in the same holding-company system;

(2) the security is not reasonably adapted to the earning power of the declarant;

* * * * *

Section 9—

(a) Unless the acquisition has been approved by the Commission under section 10, it shall be unlawful—

(1) for any registered holding company or any subsidiary company thereof, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, to acquire, directly or indirectly, any securities or utility assets or any other interest in any business;

* * * * *

Section 10—

Among the standards for Commission approval of applications for acquisition of securities under Section 9 are the following:

* * * * *

(b) If the requirements of subsection (f) are satisfied, the Commission shall approve the acquisition unless the Commission finds that—

* * * * *

(2) in case of the acquisition of securities or utility assets, the consideration, including all fees, commissions, and other remuneration, to whomsoever paid, to be given, directly or indirectly, in connection with such acquisition is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the utility assets to be acquired or the utility assets underlying the securities to be acquired;

* * * * *

Section 11—

(a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. * * * Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

* * * * *

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection

(b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. * * *

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. * * *

Section 12—

* * * * *

(c) It shall be unlawful for any registered holding company or any subsidiary company thereof, by use of the mails or any

means or instrumentality of interstate commerce, or otherwise, to declare or pay any dividend on any security of such company or to acquire, retire, or redeem any security of such company, in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate to protect the financial integrity of companies in holding-company systems, to safeguard the working capital of public-utility companies, to prevent the payment of dividends out of capital or unearned surplus, or to prevent the circumvention of the provisions of this title or the rules, regulations or orders thereunder.

* * * * *

Section 15—

(a) Every registered holding company and every subsidiary company thereof shall make, keep, and preserve for such periods such accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers or for the enforcement of the provisions of this title or the rules, regulations, or orders thereunder.

* * * * *

(f) All accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records kept or required to be kept by persons subject to any provision of this section shall be subject at any time and from time to time to such reasonable periodic, special, and other examinations by the Commission, or any member or representative thereof, as the Commission may prescribe. The Commission, after

notice and opportunity for hearing, may prescribe the account or accounts in which particular outlays, receipts, and other transactions shall be entered, charged, or credited and the manner in which such entry, charge, or credit shall be made, and may require an entry to be modified or supplemented so as properly to show the cost of any asset or any other cost.

* * * * *

(i) The Commission, by such rules and regulations as it deems necessary or appropriate in the public interest or for the protection of investors or consumers, may prescribe for persons subject to the provisions of subsection (a), (b), (c), or (d) of this section uniform methods for keeping accounts required under any provision of this section, including, among other things, the manner in which the cost of all assets, whenever determinable, shall be shown, the methods of classifying and segregating accounts, and the manner in which cost-accounting procedures shall be maintained.

Section 20—

(a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this title, including rules and regulations defining accounting, technical, and trade terms used in this title. Among other things, the Commission shall have authority, for the purposes of this title, to prescribe the form or forms in which information required in any statement, declaration, application, report, or other document filed with the Commission shall be set forth, the

items or details to be shown in balance sheets, profit and loss statements, and surplus accounts, the manner in which the cost of all assets, whenever determinable, shall be shown in regard to such statements, declarations, applications, reports, and other documents filed with the Commission, or accounts required to be kept by the rules, regulations, or orders of the Commission, and the methods to be followed in the keeping of accounts and cost-accounting procedures and the preparation of reports, in the segregation and allocation of costs, in the determination of liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the keeping or preparation, where the Commission deems it necessary or appropriate, of separate or consolidated balance sheets or profit and loss statements for any companies in the same holding-company system.

(b) In the case of the accounts of any company whose methods of accounting are prescribed under the provisions of any law of the United States or of any State, the rules and regulations or orders of the Commission in respect of accounts shall not be inconsistent with the requirements imposed by such law or any rule or regulation thereunder; nor shall anything in this title relieve any public-utility company from the duty to keep the accounts, books, records, or memoranda which may be required to be kept by the law of any State in which it operates or by the State commission of any such State. But this provision shall not prevent the Commission from imposing such additional requirements regarding reports or accounts as it may deem necessary or

appropriate in the public interest or for the protection of investors or consumers.

* * * * *

Rule U-46 of the S. E. C. General Rules and Regulations under the Public Utility Holding Company Act of 1935, relating to dividend declarations and payments on certain indebtedness, provides in pertinent part as follows:

> (*a*) *Dividends.*—No registered holding company or subsidiary thereof shall declare or pay any dividends on any security of such company out of capital or unearned surplus, except pursuant to a declaration notifying the Commission of the proposed transaction, which has become effective in accordance with the procedure specified in rule U-23, and pursuant to the order of the Commission with respect to such declaration under the applicable provisions of the Act.

Section 318 of Title II of the Public Utility Act of 1935 provides as follows:

> If, with respect to the issue, sale, or guaranty of a security, or assumption of obligation or liability in respect of a security, the method of keeping accounts, the filing of reports, or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 or of a rule, regulation, or order thereunder and to a requirement of this Act or of a rule, regulation, or order thereunder, the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this Act, or of any rule, regulation, or order thereunder, with respect to the

same subject matter, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this Act shall apply to such person.

The opinion of the S. E. C. in Northwestern Electric Co., 6 S. E. C. 57 (1939) is as follows:

SECURITIES AND EXCHANGE COMMISSION,
WASHINGTON

FINDINGS AND OPINION OF THE COMMISSION

In the Matter of

NORTHWESTERN ELECTRIC COMPANY

File No. 32–173

(Public Utility Holding Company Act of 1935—Section 6 (b))

[Appearances omitted]

Northwestern Electric Company, a direct subsidiary of American Power & Light Company, a registered holding company, and an indirect subsidiary of Electric Bond and Share Company, also a registered holding company, has filed an application and amendments thereto, pursuant to Section 6 (b) of the Public Utility Holding Company Act of 1935 for exemption from the provisions of Section 6 (a) of said Act regarding the issuance and sale of $6,700,000 principal amount First Mortgage Bonds, 4% Series due 1969, and $2,800,000 principal amount 4½% Debentures due 1959.

A public hearing was held on the application, as amended, after appropriate notice. The Commission has examined the record in this matter and now makes the following findings:

Northwestern Electric Company (hereinafter sometimes referred to as "Northwestern" or as "applicant"), incorporated in 1911 under the laws of the State of Washington, is engaged in the business of furnishing electric service in Portland, Oregon, Vancouver, Washington, and in various other communities and rural areas in certain counties in the States of Washington and Oregon, as well as steam heating service in Portland. The company has no subsidiaries.

American Power & Light Company is one of the major subholding companies in the Electric Bond and Share holding-company system.

Capitalization of Northwestern

The following tabulation sets forth the capitalization and surplus of Northwestern as at June 30, 1939, both before and after giving effect to the proposed transactions:

	Before financing		After financing	
	Amount	Per cent	Amount	Per cent
Long-Term Debt:				
First Mortgage, Twenty Year Sinking Fund 6% Gold Bonds, due 1955, extended to 1945	$5,371,900	28.6		
Demand loan payable to American Power & Light Company, subordinated to long-term debt as to payment of principal	2,819,600	15.0		
First Mortgage Bonds, 4% Series due 1969			$6,700,000	35.7
4½% Debentures due 1959			2,800,000	14.9
Total Long-Term Debt	8,191,500	43.6	9,500,000	50.6
Capital Stock:				
Preferred Stock:				
First preferred (7%), cumulative, $100 par, 47,343 shares outstanding	4,734,300	25.3	4,734,300	25.4
Preferred (6%), cumulative, $100 par, 611 shares outstanding	61,100	.3	61,100	.3
Total Preferred Stock	4,815,400	25.6	4,815,400	25.7
Common Stock, $35 par, 100,000 shares outstanding	3,500,000	18.6	3,500,000	18.7
Surplus:				
Earned Surplus	[1] 2,293,571	12.2	918,479	5.0
Total Capitalization and Surplus	18,800,480	100.0	18,733,879	100.0

[1] Before deducting preferred dividend arrears in the aggregate amount of $1,037,381.

Securities To Be Offered

The $6,700,000 principal amount of bonds to be issued which are to be secured by a Mortgage and Deed of Trust dated as of September 1, 1939, between applicant and Harris Trust and Savings Bank and Harold Eckhart, as Trustees, will, in the opinion of counsel for Northwestern, when duly executed and recorded and upon the discharge of the mortgage securing the presently outstanding bonds, constitute a first lien on substantially all the company's physical property and franchises.

The Mortgage and Deed of Trust provides that subject to the orders of any regulatory authorities, the applicant will each year, beginning with the year 1940, expend, accrue, or appropriate on its books at least 13½% of its gross operating revenues, after deducting the cost of electricity, gas, and steam purchased and certain other items, for maintenance, retirement, or amortization of property. The mortgage requires the applicant to deliver to the trustee on or before October 1 of each year, beginning with the year 1950 to and including the year 1959, an amount in cash and or principal amount of such series of bonds equal to 1½% of the greatest principal amount of bonds outstanding prior to January 1 of such year. Such sinking fund is increased to 1% from October 1, 1960, to and including October 1, 1968. The mortgage also requires the applicant, beginning October 1, 1940, to deliver annually to the trustee an amount in cash or principal amount of bonds for each series equivalent to 1% of the greatest principal amount of bonds of such series outstanding

at any one time. There may be credited against the amount so payable the aggregate principal amount of bonds which the company shall then be entitled to issue and which the company waives its right to issue. The mortgage also provides that so long as any of the bonds now proposed to be issued are outstanding, the applicant will not pay any dividend upon its common or preferred stocks (excepting dividends payable in its common stock), or make any disbursement for the purchase of its stock or make any distribution in liquidation of any of its stock if its surplus is thereby reduced below the amount as of August 31, 1939, less dividend arrears as of that date, and after certain adjustments.

The $2,800,000 principal amount of 4½% Debentures due 1959, are to be issued under an Agreement dated as of September 1, 1939, between the Company and the City Bank Farmers Trust Company, as Trustee. The debentures, which are to be unsecured, will be entitled to the benefit of a sinking fund requiring Northwestern to deposit annually with the trustee, beginning November 1, 1940, $140,000 in cash for the purpose of the redemption of the debentures; as an alternative, Northwestern may deposit debentures to be credited against the cash requirements at the cost thereof to Northwestern. The sinking fund is calculated to retire the entire issue by maturity. The Debenture Agreement permits the applicant to issue without restriction indebtedness maturing within not more than one year but places certain restrictions upon the issuance of debt of a longer maturity.

The securities proposed to be issued are to be sold privately as follows:

First Mortgage Bond, 4% Series due 1969:		
The Equitable Life Assurance Society	$5,850,000	
Sun Life Assurance Company of Canada	500,000	
Massachusetts Mutual Life Insurance Company	250,000	
Oregon Mutual Life Insurance Co	100,000	
		$6,700,000
4½% Debentures due 1959:		
American Power & Light Company [1]		2,800,000
Total Securities		$9,500,000

[1] American Power & Light Company has agreed that in the event it shall at any time derive any profit from the sale or other disposition of these debentures it will contribute an amount equal to such profit to Northwestern, so long as Northwestern shall remain as its subsidiary.

Plant, Property, and Equipment

The plant, property, and equipment of Northwestern are stated on its books as at June 30, 1939, in the amount of $21,143,574.36.[2]

Applicant states that plant, property, and equipment (including intangibles) acquired at organization are stated on the basis of applicant's valuation thereof (as adjusted in September 1936) where acquired by the issuance of stocks and other securities, and since organization are stated on the basis of cost where acquired for cash or constructed,[3] less retirements at actual or estimated cost. The ledger value does

[2] This is after giving effect to a reduction of $6,500,000 in September 1936, no actual retirement of property being involved. This reduction purported to give effect to the results of an appraisal of the property. The amount of the reduction was charged to capital surplus, such surplus being created by a reduction in the par value of common stock from $100 to $35 per share.

[3] Including, in addition to direct engineering and supervision, proportions of general and administra-

not purport to represent present realizable value or replacement cost.

The record indicates that the plant, property, and equipment account includes admitted intangibles in the amount of $3,879,519.93 as at June 30, 1939.[4] Applicant's gross property account per books of $21,143,574.36 as at June 30, 1939, after deducting admitted intangibles, is reduced to $17,264,054.43.

Under date of May 27, 1939, there was submitted to the Federal Power Commission, for filing, the applicant's original cost study. The original cost of plant and property as of January 1, 1937, as indicated by the study was $21,870,904.53 as compared with the book cost at the same date of $21,029,369.96. However, the Federal Power Commission, by letter, notified the applicant that there were items amounting to $4,585,546.51,[5] included in applicant's original cost study which could not be accepted by it as constituting original cost. The applicant has not acquiesced in this notification.

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tive expenses and interest during construction determined by the applicant to be chargeable to construction.

[4] Itemized as follows:

Organization cost	$3,769,161.81
Franchise costs	868.57
Miscellaneous intangible capital expenditures prior to July 1, 1914	109,489.55
Total	3,879,519.93

[5] Itemized as follows:

Organization expenses	$3,500,000.00
Interest during construction	34,959.79
Interest and taxes on construction materials	238,230.52
General expenses previously charged to operating expense	780,922.75
Interest on cash balance applicable to construction	31,443.45
	4,585,546.51

The retirement reserve reflected on the books of Northwestern at June 30, 1939, amounted to $2,705,925, or 12.8% of utility plant. If the admitted intangibles are excluded from the utility plant, the reserve will amount to 15.67% of utility plant.

The applicant states that it has been its general practice to provide for retirements of property by making such provisions from current income as are considered by the management necessary to provide for retirements when they occur, such provisions being in addition to expenditures included in operating expenses to maintain the properties in condition to render adequate service. The uniform systems of accounts prescribed by regulatory bodies to whose jurisdictions the applicant is subject provide that in the future depreciation rather than retirement accounting shall be followed. Applicant states that at this time it cannot determine the extent to which this requirement will affect its accounts.

During the period 1932–1937, inclusive, the applicant's provisions for property retirements amounted to $260,000 annually. In 1938 the amount was increased to $300,000.[6] During the years 1936, 1937 and 1938 the combined maintenance charges and provisions for retirement charged by applicant against income per books amounted to 10.33%, 11.52% and 12.84% of operating revenue as defined in the mortgage, respectively, and for the twelve months ended June 30, 1939, amounted to 12.69% of such operating revenue. Applicant has filed a consent in this proceeding

[6] In each of such years the depreciation allowed or allowable by the Bureau of Internal Revenue exceeded $520,000.

that a provision with respect to the minimum aggregate maintenance charges and provisions for retirement to be made during the life of the bonds and the debentures to be issued may be incorporated in our order, the terms of which are as follows:

That except as the Commission may by order, or orders, from time to time, permit, so long as any of the First Mortgage Bonds, 4% Series due 1969, and 4½% Debentures due 1959, are outstanding, applicant shall not, nor shall any successor or successors of applicant, declare or pay any dividends (other than dividends payable solely in shares of its stock and other than dividends in arrears on October 1, 1939, on the preferred stocks of the applicant) or make any other distribution on any shares of its preferred or common stock, or make any disbursement for the purchase or retirement of any of its stock, unless the amount expended or accrued by applicant (or any such successor or successors) for maintenance and repairs plus provisions for retirements out of income earned during the period from October 1, 1939, to the date of the proposed payment of such dividend or making of such distribution or disbursement shall equal fifteen per cent of the gross operating revenues of applicant (or any such successor or successors) during such period, after the deduction therefrom of an amount equal to the cost to applicant of electric energy, gas, steam and hot water purchased, and resold, and rentals paid for electric, gas, steam and hot water properties leased by applicant, and payments by applicant for the use of similar properties operated and maintained by others during such period; provided, however, that any

transfers to the earned surplus of applicant from net income earned after September 30, 1939, over and above all such dividends, distributions, and disbursements (including the dividends then to be paid, or the distributions or disbursements then to be made) may be used as a credit to offset any deficiency in the amount expended or accrued for maintenance and repairs plus provisions for retirements out of income earned after September 30, 1939, in satisfying the aforementioned fifteen percent requirement, and provided further that in no event shall the applicant declare or pay any dividends on its common stock except out of earnings accruing subsequent to said September 30, 1939.

The funded debt of Northwestern to be outstanding will consist of $6,700,000 principal amount First Mortgage Bonds, 4% Series due 1969 and $2,800,000 4½% Debentures due 1959. The bonds to be outstanding will amount to 31.68% of the gross ledger value of plant, property and equipment as at June 30, 1939 and to 36.34% of the property, less retirements, as at the same date. If admitted intangibles are excluded for the purpose of this calculation, the bonds to be outstanding will amount to 37.01% of the gross ledger value as adjusted and to 43.51% of the depreciated book value as adjusted.

The ratio of bonds and debentures to the gross property value per books will be 44.9% and to the property, less retirements, 51.5%. If the adjustments mentioned in the preceding paragraph are made, the ration of bonds and debentures to plant, property, and equipment becomes 52.5% and 61.7% respectively.

Earnings

On the basis of gross income of the applicant for the years 1936, 1937, and 1938, the interest requirements on the bonds proposed to be issued would have been covered 4.16, 4.37, and 3.84 times, respectively. For the same period the coverage for interest requirements on bonds and debentures to be outstanding would have been 2.83, 2.97, and 2.61 times, respectively. On a proforma basis for the twelve months ended June 30, 1939 interest requirements on the bonds would be earned 4.03 times and total interest requirements 2.74 times. As a result of the proposed financing, the estimated decrease in annual fixed charges will be $107,489. The applicant proposes to write off directly to earned surplus the balance of unamortized debt, discount and expense in the amount of $41,239.46 and the call premium of $161,157 on the bonds being redeemed, and duplicate interest of $115,314.76.

Use of Proceeds

The bonds and debentures are to be sold privately at 100. No underwriting fees or commissions are to be paid. The estimated total expenses of $77,000 include a $35,000 payment to the First Boston Corporation for services rendered as agent of the applicant in negotiating the sale of the bonds.

The estimated net proceeds from the proposed financing will amount to $9,423,000 (exclusive of accrued interest) as follows:

	Amount
Sale of bonds	$6,700,000
Sale of debentures	2,800,000
Total	9,500,000
Less expenses—estimated	77,000
	9,423,000

The net proceeds will be used as follows:

(1) To deposit with Harris Trust and Savings Bank, the Corporate Trustee, under the Trust Indenture made by the applicant to said corporate trustee dated May 1, 1915, in trust, cash equal to principal, and premium (exclusive of accrued interest) required for redemption (in accordance with the terms of the said Trust Indenture) on May 1, 1940, of applicant's outstanding First Mortgage Twenty-Year Sinking Fund Gold Bonds, as extended to May 1, 1945, less cash in sinking fund amounting to $210,837.34 and cash in special deposits amounting to $7,501.81 with trustee	$5,314,717.85
(2) To pay the $2,819,609.51 principal amount of indebtedness (exclusive of accrued interest) owing by applicant to American Power & Light Company	2,819,609.51
(3) To reimburse applicant's treasury, in part, for expenditures heretofore made for extensions and improvements of the applicant's facilities	1,288,672.64
Total	9,423,000.00

After the sale of the said securities and the reimbursement of applicant's treasury, as above stated, the company intends, upon appropriate declaration thereof, to pay from applicant's earned surplus previously undeclared dividends on its First Preferred Stock (7%) and Preferred Stock (6%) amounting to a total of $1,057,381.29 as of June 30, 1939.[1]

The sale of the securities will provide funds to enable Northwestern to pay the

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[1] Dividends on the First Preferred Stock (7%) and Preferred Stock (6%), which are cumulative, were in arrears $21.87 and $34.50 per share, respectively, as of June 30, 1938. During the 12 months ended June 30, 1939, dividends aggregating $7 per share were declared on the First Preferred Stock (7%).

In this connection it is to be noted that though the preferred dividends are in arrears, the company earned its dividend requirements except in the years 1932, 1933, and 1934. Since 1935 applicant has been required to make substantial payments to the sinking fund.

$2,819,609.51 principal amount of indebtedness (exclusive of accrued interest) owing by it to American Power & Light Company. This balance is the amount remaining on a loan account to which debits and credits have been made since December 1925. Interest was paid quarterly at the rate of 6% per annum. A summary of the account appears below.[8]

In addition, during the period 1927 to 1931, inclusive, Northwestern in lieu of paying common stock dividends in cash paid them with demand notes (bearing interest at the rate of 6% per annum). A total of $649,957 face amount of such demand notes were so issued to American Power & Light Company. Northwestern paid in cash the entire $649,957 note obligations during the period July 15, 1933 to January 23, 1934, and $585,000 of this total was paid between July 15 and December 17, 1933. During such latter period the applicant borrowed from

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[8] A summary of Northwestern's Loan Account with American Power & Light Company follows:

Credits:		
Cash Received		$9,711,046.00
Interest Charges		1,039,642.83
N. E. Bonds purchased by American Power & Light Company		626,338.57
Payment to Phoenix Engineering Corporation by American Power & Light Company for account of Northwestern		2,200.00
Total		11,379,227.40
Debits:		
Cash Paid	$7,040,531.94	
Transferred to Havana Electric Utility Co	80,000.00	
Sale of properties to Inland P. & L. Co. and Pacific Power & Light Co	1,439,085.95	
		8,559,617.89
Balance, June 30, 1939		2,819,609.51

American Power & Light Company $541,415 on the aforementioned loan account.[9]

Compliance with the Act

Section 6 (b) of the Act provides that the Commission shall exempt from the provisions of Section 6 (a) "subject to such terms and conditions as it deems appropriate in the public interest or for the protection of investors or consumers" the issue or sale of any security.

"* * * by any subsidiary company of a registered holding company, if the issue and sale of such security are solely for the purpose of financing the business of such subsidiary company and have been expressly authorized by the State commission of the State in which such subsidiary company is organized and doing business. * * *"

The Public Utilities Commissioner of Oregon and the Department of Public Service of Washington have authorized the issuance and sale of the First Mortgage Bonds, 4% Series due 1969, and the 4½% Debentures due 1959 proposed to be issued.[10] The Commission concludes that the proposed issue and sale of the $6,700,000 principal amount First Mortgage Bonds, 4% Series due 1969 and $22,800,000 4½% Debentures

[9] The Public Utilities Commissioner of Oregon by order, dated October 3, 1939, approved increases in this account in the amount of $450,382.47 during June 1933 to December 1934. The order also states that its Department of Finance and Accounts "has analyzed the transactions as recorded upon the books of the applicant between applicant and the American Power & Light Company and finds that said America Power & Light Company made no profit on any of said transactions."

[10] Public Utilities Commissioner of Oregon, Order No. 6904, October 11, 1939; The Department of Public Service of Washington, Order No. 7285, October 11, 1939.

due 1959 are solely for the purpose of financing the business of the applicant.

An appropriate order approving the application granting exemption from the provisions of Section 6 (a) of the Act will be issued. The order will, however, impose the following conditions upon the applicant:

(1) That if the express authorizations of the issue and sale of such securities by The Public Utilities Commissioner of Oregon or the Department of Public Service of Washington were to be revoked and otherwise terminated, this exemption shall immediately terminate without further order of this Commission;

(2) That the securities proposed to be issued shall be issued within 30 days after the date of our order;

(3) That within 10 days after the issue and sale of such securities applicant shall file with this Commission a certificate of notification showing that such issue and sale have been effected in accordance with the terms and conditions of and for the purposes represented by such application as amended and in accordance with the terms of this order; and

(4) That except as the Commission may by order or orders, from time to time, permit, so long as any of the First Mortgage Bonds, 4% Series due 1969, and 4½% Debentures due 1959, are outstanding, applicant shall not, nor shall any successor or successors of applicant, declare or pay any dividends (other than dividends payable solely in shares of its stock and other than dividends in arrears on October 1, 1939, on the preferred stocks of the applicant) or make any other distribution on any shares of its preferred or common stock, or make any disbursement for the purchase or retirement of any of its stock, unless the

amount expended or accrued by applicant (or any such successor or successors) for maintenance and repairs plus provisions for retirements out of income earned during the period from October 1, 1939, to the date of the proposed payment of such dividend or making of such distribution or disbursement shall equal fifteen per cent of the gross operating revenues of applicant (or any such successor or successors) during such period, after the deduction therefrom of an amount equal to the cost to applicant of electric energy, gas, steam and hot water purchased, and resold, and rentals paid for electric, gas, steam and hot water properties leased by applicant, and payments by applicant for the use of similar properties operated and maintained by others during such period; provided, however, that any transfers to the earned surplus of applicant from net income earned after September 30, 1939, over and above all such dividends, distributions, and disbursements (including the dividends then to be paid, or the distributions or disbursements then to be made) may be used as a credit to offset any deficiency in the amount expended or accrued for maintenance and repairs plus provisions for retirements out of income earned after September 30, 1939, in satisfying the aforementioned fifteen per cent requirement, and provided further that in no event shall the applicant declare or pay any dividends on its common stock except out of earnings accruing subsequent to said September 30, 1939.

An appropriate order will issue.

By the Commission. Commissioners Mathews and Healy being absent at the time of the Commission's consideration of this case and not participating therein.

U. S. GOVERNMENT PRINTING OFFICE: 1943